

Tax Newsletter



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Dear Sirs,

In the December edition of the Tax Newsletter we present selected positions of tax authorities concerning the VAT (including the scope of applying the 0% rate in Intra-community Delivery of Goods and the VAT calculated in the case of assignment of operating leasing agreement) and the CIT (tax treatment of a remitted debt). We also discuss one of the "heated" subjects concerning transfer pricing connected with granting loans among affiliated entities, and their valuation.

I would also like to take the opportunity to invite you to read the January edition of the Tax Newsletter, in which we will present the most important changes in tax regulations to be introduced from 2011.

On behalf of the Tax Advisory Department I wish you Merry Christmas and all the best in the New Year.

Yours faithfully,

Krystyna Szydłowska

EDITORIAL

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VAT - Purchase of a claim aiming its execution constitutes a VAT taxed service on the basic rate

Such conclusions result from the Warsaw Tax Chamber Director's (TCD) individual interpretation as of 3 September 2010 (Ref. number IPPP3/443-243/09-5/S/MM).

The subject of the taxpayer's (bank's) application was the qualification, in accordance with VAT, of so called eFinancing services. These services, in spite of variety of their forms offered by the bank, consisted mainly of the bank's purchasing the claims to be paid in the amount calculated as a nominal value of the claim being purchased less a proper discount amount. The service of eFinancing was resulting for a debtor in an obligation of providing a service to the purchaser of the claim, that is the bank. Furthermore, in particular cases the bank could provide additional services, such as monitoring of a claim and its administrating, keeping an account for repayment and accounting the payments coming into this account, making claim data accessible in the form of reports, and so on.

Due to the presented factual circumstances, the bank addressed an application to the Minister of Finance, willing to confirm that the provided services constitute financial agency services which are VAT-free on the basis of Article 43 section 1 point 1 in relation to item 3 of the appendix No. 4 to the VAT Act. In its application for interpretation, the taxpayer presented a wide argumentation in which he indicated that the provided services constitute VAT-free financial agency services. At the same time, the taxpayer was proving that his services cannot be qualified as debt collection services or factoring services which are excluded from the range of VAT-free finance services.

Acting on the behalf of Minister of Finance, Warsaw TCD in its issued interpretation stated, considering at the same time the taxpayer's position as incorrect, that the services described in the application fulfill the criteria of factoring. Therefore, in the opinion of the authority, exemption from VAT taxation provided for financial agency services does not apply in the case of eFinancing services. These services are subject to VAT basic rate taxation.

It is hereby noteworthy that in specific situations purchasing of a claim can be also qualified for the needs of VAT as a debt collection service (see: VAT – Assignment of claim – latest judicial decisions) which, together with factoring, is also excluded from the range of VAT-free financial services. Therefore, in practice, in order to correctly assess the tax results of a claim assignment transaction, in each case **the legal character of a given transaction should be analyzed in details**. It is important insofar as debt collection services and factoring services are directly defined neither on the grounds of the VAT Act nor EU regulations, nor even on the grounds of civil code (these services are classified in the group of unnamed agreements). Consequently, the possibility of qualifying a claim assignment agreement to one of the above mentioned categories may depend on details of a given transaction (such as additional compulsory services of claim's purchaser). Unfortunately, the tax authorities, when assessing the legal character of a claim assignment agreement, relatively rarely make a deeper analysis of this transaction. The discussed interpretation of Warsaw TCD is the best example of it.

VAT - Profitable resolution of the Supreme Administrative Court of Poland regarding documentation requirements for 0% rate application in intra-community delivery of goods

In the light of regulations of the VAT Act, the intra-community delivery of goods ("IDG") is subject to 0% rate taxation, under the condition of fulfilling, by the person acquiring IDG, detailed documentation conditions defined in the VAT Act.

Particularly, according to the Article 42 section 3 of the VAT Act, a taxpayer willing to apply the 0% rate in relation to IDG should have, before submitting the tax return form for the given settlement period, the following documents confirming that the good being subject to IDG were actually exported from Poland and delivered to the purchaser on the territory of another EU country: shipping documents received from the carrier, a copy of the invoice and specification of particular pieces of load. In the case when the above mentioned documents do not unequivocally confirm the delivery of the goods to the purchaser on the territory of another EU country, there is a possibility of using additional documents, indicated in details in Article 42 section 11 of the VAT Act.

In practice, the above mentioned regulations became a reason of numerous disputes between taxpayers and tax authorities, which also often became the subject of Voivodship Administrative Courts' ("VAC") settlements. The essence of the problem consisted namely in deciding if, for applying a 0% VAT rate in IDG, it is necessary for taxpayer to have all the documents mentioned in Article 42 section 3 of the VAT Act which, in the case of ambiguities, can be additionally completed with the documents indicated in Article 42 section 11 of the VAT Act, or if using these additional documents is possible also in the case of not having all the documents from the Article 42, section 3 of the VAT Act. The hitherto judicial decisions in the above scope were unfortunately inconsistent and at the same time did not resolve the taxpayers' doubts. Some courts were interpreting the analyzed regulations in a rigorous way, by making the possibility of applying the 0% VAT rate dependent on having all the documents mentioned in Article 42 section 3 of the VAT Act (for example the Cracow VAC in its sentence as of 23 February 2010, Ref. No. I SA/Kr 1808/09). However, a more literal jurisprudence emerged, allowing the possibility of reporting IDG by means of the documents mentioned in Article 42 section 11 of the VAT Act also in the case of not having all the documents mentioned in section 3 of this article (for example VAC in Bydgoszcz in its sentence as of 20 January 2010, Ref. No. I SA/Bd 926/09).

Due to the inconsistent judicial decisions of administrative courts, the Supreme Administrative Court of Poland, when adjudicating a next litigation concerning documentation requirements conditioning the possibility of taxation of IDG with 0% VAT rate, decided to present the discussed problem, to be adjudicated in the form of a resolution, to the panel of seven judges of SAC. In the resolution passed on 11 October 2010 (Ref. No. I FPS 1/10) the judges of SAC decided that in the light of Article 42 section 1, 3 and 11 of the VAT Act it is sufficient for application of 0% VAT rate that the taxpayer has only some of the proofs mentioned in Article 42 section 3 of the VAT Act, completed with the documents mentioned in section 11 of this article, as far as they confirm together the fact of exporting and delivering the goods being subject of IDG to the purchaser being located on the territory of a member state other than the territory of the country. It was stated in the justification of the resolution that the 0% VAT rate is in the case of IDG neither an exception, nor a privilege, but a rule resulting from the free movement of goods in EU, preventing a double VAT taxation for the same goods. Therefore, the interpretation of the regulations of the VAT Act

concerning the taxation of IDG should be made taking into consideration the above mentioned rule.

The mentioned regulation of SAC deserves full approval. In practice, it means that the judicial decisions of administrative courts in similar factual circumstances should be uniform and advantageous for taxpayers. Consequently, even with regard to legal costs, maybe it will also influence the liberalization of tax authorities' positions.

VAT - Unsettled invoices issued in 2008 - last chance to profit from the bad debts relief

Taxpayers may, by the end of December 2010, profit from the so called bad debts relief (article 89a of the VAT Act) concerning unsettled invoices which were issued in 2008.

According to the article 89a section 1 of the VAT Act, a taxpayer is entitled to adjust the tax due on account of delivery of goods or providing of services on the territory of a country in the case of debts of which the non-recovery was made out, i.e. such a claim was not settled in the course of 180 days from expiry of the term of payment defined in an agreement or on the invoice.

The right to profit from the relief depends on fulfilling jointly the following conditions:

- delivery of goods or providing of services was made for the taxpayer registered as an active VAT payer, not being in the course of bankruptcy proceedings or a liquidation;
- the claims were previously reported in a declaration as a taxed transaction and a tax due;
- the debtholder and the debtor as of the adjustment date (due to profiting from a bad debt relief) are taxpayers registered as active VAT payers;
- the debts have not been sold;
- the debtholder informed the debtor about the intention to adjust the tax due for applying the relief for incorrect services, and the debtor, within 14 days from the date of receiving the notification, did not settle the amount due in any form (the condition of adjustment is the debtholder's obtaining of a report of debtor's receiving such a notification)
- **2 years since the date of issuing the invoice documenting the debt have not passed, counting from the end of the year in which it was issued.**

The adjustment of the due tax may take place in the settlement for the settlement period in which the 14-day due period beginning in the day of informing the debtor about the intention of adjustment passed, not earlier than in the settlement for the period in which the debtholder obtained a report of debtor's receiving such a notification.

VAT - Assignment of operating leasing agreement - lack of obligation of adjustment of tax deductible costs and of input VAT

In the light of the CIT Act regulations, the leasing charges incurred during the primary lease period constitute a tax deductible cost for a lessee provided that the agreement meets the conditions specified in the CIT Act.

One of these conditions is the requirement of the agreement's being concluded for a definite period of time, constituting at least 40% of the normative depreciation period (or for a period of at least 10 years, if it concerns depreciable real property). The above requirement gives rise to taxpayers' doubts concerning the results that may occur for them on the grounds of CIT and VAT in the situation when the leasing agreement is assigned to another entity before mentioned due dates. Particularly, taxpayers are not sure if in such situation the obligation of adjustment of tax deductible costs level by the value of leasing charges paid will become attributable to them and if the adjustment of deductible VAT, calculated from these charges, will be necessary.

In the opinion of tax authorities, the assignment of a leasing agreement does not result for the lessee in the necessity of adjustment of deductible costs (for example TCD in Poznań in the interpretation as of 4 March 2009, Ref. No. ILPB3/423-838/08-2/KS and TCD in Katowice in the interpretation as of 16 November 2009, Ref. No. IBPBI/2/423-981/09/MS). As the authorities remark, the CIT Act does not include the regulations obliging the leaseholder to exclude the leasing charges from the deductible costs in the situation when an assignment of leasing agreement to another entity took place prior to the lapse of period for which it was concluded. Consequently, in the opinion of authorities, the leasing charges may be classed as leaseholder's tax deductible costs, under the condition, however, that they meet the general definition of tax deductible costs included in the Article 15 section 1 of the CIT Act.

The position of tax authorities in the above scope should be considered correct. The CIT Act, as a matter of fact, does not include any regulations requiring the adjustment of deductible costs in the above mentioned circumstances, but it also does not provide for the obligation of recognition of additional income in the amount corresponding with the total of leasing charges classed as tax deductible costs (recognition of an additional income "compensating" the amount of expenses incorrectly classed as tax deductible costs is a solution applied on the grounds of the CIT Act, leading to similar purposes as the adjustment reducing the level of deductible costs, yet without the necessity of back verification of tax returns).

Moreover, tax authorities consider that the assignment of operating leasing agreement prior to the lapse of period for which it was concluded does not either give rise to an obligation of adjustment of amounts of the input VAT, deducted by the lessee from invoices documenting specific leasing charges (for example TCD in Bydgoszcz in the interpretation as of 27 April 2010, Ref. No. ITPP2/443-122/10/MD). For, while the subject of the leasing agreement served the lessee for the purpose of carrying out the VAT taxed activities, there are no legal basis for this agreement allowing to assume that the further assignment of the leasing agreement results, for the leaseholder, in loss of the right to deduct the VAT input "retroactively". Therefore, also on the grounds of VAT, the assignment of operating leasing agreement during its term does not influence

the possibility of deducting the VAT calculated from the invoices documenting specific rents and does not give rise to the obligation of making adjustments of tax returns.

CIT - Net value of a remitted debt as a tax deductible cost

Tax authorities stress that a deductible cost constitutes only the net value of a remitted debt, as VAT does not constitute, in the light of the CIT Act, a tax deductible cost.

According to Article 16 section 1 point 44 of the CIT Act, remitted debts, **with the exception of those which were previously booked as revenues due**, are not treated as deductible costs. Therefore, remitted debts are classed as tax deductible costs only when they were previously booked as revenues due. The basis for remitting debts is the article 508 of the Polish Civil Code which says that the obligation expires when the obligee excuses the obligor from performing and the latter accepts. It means that in order for remitting debts to be legally effective, it is essential that a debtor **accepts, otherwise agrees with, the exemption from the debt**. If the obligee excuses the obligor from the debt and the latter accepts, and the amount of the debt was previously booked as a revenue due, then the remitted debt constitutes, in the light of the CIT Act, a deductible cost.

However, according to the Article 16 section 1 point 20 of the CIT Act, remitted debts written off as overdue do not constitute a deductible cost. In order for a debt to be classed as deductible costs, it should be remitted prior to the lapse of period of prescription.

The net value of a debt may also constitute a deductible cost. It results from the fact that, as a matter of principle, from the point of view of the income tax, VAT is neutral, i.e. it is not a tax revenue (Article 12 section 4 point 9 of the CIT Act). Such position is also presented by tax authorities (i.e. interpretation IPPB1/415-601/1-2/AM).

To sum up, **it is considered that a remitted debt of net amount booked previously as revenue due constitutes a tax deductible cost.**

PIT - Changes in taxation of employee shares

The Sejm adopted on 25 November 2010 an amendment to the PIT Act. The amendment should eliminate the doubts regarding the exemption from PIT concerning the shares received in so called motivation packages at the moment of taking them up.

Let's remind that in the current legal status the exemption from tax at the moment of taking up a share concerns only the shares being taken up within a new emission. Some tax authorities take a position that an exemption in the case of taking up a share of a new emission is limited to actions issued by Polish companies.

The legislator decided to dispel the above doubts and introduced, in the amending act, a record guaranteeing the exemption from taxation not only at the moment of taking up a share of a new emission, but **also a share being acquired (or a share of an old emission)**. This is why in both

cases an employee will pay the tax only at the moment of **selling the share**, and he will deduct from the revenue the value of the papers as of the acquisition date.

Unfortunately, alongside the amendment the legislator limited the scope of applying the new rules to the shares of companies with registered office in Poland and other countries in the European Union and EEA. Thus, it will not be possible to profit from the exemption for the shares of the companies for example from the United States, deriving both from a new and an old emission. Taking into account that the new regulation comes into force from January 2010, there may occur situations in which taxpayers will settle on different basis the shares received from the same entity outside the EU and EEA (due to a different moment of taking up the shares).

Transfer pricing - Interest rate on loans in corporate groups

The loans granted by holding companies to subsidiaries constitute currently the most typical transactions being carried out within corporate groups.

The revenues earned / costs incurred on account of granted loans, as resulting from transactions concluded between affiliated entities are subject to verification with regard to the marketability of the agreed conditions. However, many times, both tax authorities and the parties involved in a transaction encounter problems with defining a right level of interest rate that could be unequivocally considered as marketable.

A payment (transaction price) for granting a loan is the value of interests and/or provisions calculated from the amount of cash made available to the related borrower. In the light of the regulations of Minister of Finance Ordinance¹ the most adequate method for indicating the interests' and provisions' market value in such case is the comparable uncontrolled price method. Applying of this method may consist in comparing loan conditions (level of interest rate/provision) with comparable transactions carried out by the same entity with independent entities (internal comparison), or with the ones being applied in comparable transactions concluded between nonaffiliated entities (external comparison).

The most commonly applied basis for comparisons is constituted by the available data concerning the interest rate of bank credits. This position is shared by the courts (*vide*: sentence as of 25 June 2009 Ref. No. I SA/Ke 195/09) which are referring at the same time to the records of the Ordinance (§ 21 section 2²) in the part defining specific cases of determining of market value of intangible services, according to which the basis for establishing the level of interests should be constituted by the lowest level of interest rate from among the available bank offers. However, the level of interest rate should not always be established exactly on the level formed by the banks or other financial institutions. The used data should be verified with regard to comparability, to which,

¹ Minister of Finance Ordinance dated 10 September 2009 on the method and procedure for assessing taxpayers' income by estimating the prices in transactions conducted by these taxpayers, and on the method and procedure for eliminating double taxation of taxpayers in case of related parties' income adjustment (Journal of Laws No. 160, item 1267)

² §15 section 2 according to the Minister of Finance Ordinance dated 10 October 1997 on the Mode and Procedure of Determining Taxpayers' Income by Estimating Prices in Transactions Effected by These Taxpayers applicable on the date of rendering the verdict

moreover, directly oblige the regulations concerning the transfer pricing. A detailed analysis should include among others the amount, the currency and the period for which the funds are being made available, character and purpose of the loan/credit, conditions (periods) of interests calculation, and the elements influencing the level of credit risk, i.e. occurrence / lack of protections, borrower's financial situation, etc.

Therefore, in order to establish the level of loans' interest rates in a corporate group, a complex analysis of all benefits gained by a lender, on account of making available of the subject funds which may justify / compensate the difference in the obtained interest rate, is necessary. Among the benefits there is for example the possibility of earning in future the revenues among others from the cooperation with the borrower (products sale / goods distribution by the affiliated entity on a given market) or payment of dividends, and possible savings consisting of optimizing the functioning of entities in the group / business processes carried out by for example outsourcing of certain scopes of activity.

The analysis of this type carried out on the stage of defining the interest rate constitutes an important starting point for justifying and defending the agreed conditions of loans in the case of their being questioned by tax authorities referring to the bank loans/credits. For the character and purpose of granted loans in corporate groups allow justifying their different treatment in relation with the funds being made available by financial institutions, as well as their valuation. Therefore, a properly prepared argumentation based on a complex analysis of economic benefits should constitute a basic criterion for assessment, used also in discussion with tax authorities.

Tax Ordinance Act - Higher interests for delays

The Act dated 24 September 2010 amending the Tax Ordinance Act and the act on the terms of registration and identification of taxpayers and tax remitters (Journal of Laws of 2010, No. 197, item 1306) introduced changes in the hitherto rules of calculation of interests for delays. New regulations entered into force on 9 November this year.

The hitherto binding regulations of the Ordinance provided that the rate of interests for delays constitute 200% of the basic interest rate of a lombard credit established according to regulations about the National Bank of Poland. The rate of interests established in this way amounted to 10% (in the period from 25 June 2009 to 8 November 2010), The Ministry of Finance was postulating changes of these regulations, because it observed a growing increase in the difference between the rate of interests for delays and the rate of interest rate of working capital facilities in banks, which, in a further perspective, would lead to the loss of disciplinary character of calculation of interests for delays.

The regulations binding from 9 November take into consideration the demands of Ministry of Finance. According to the currently binding article 56 § 1 of the Ordinance, the rate of interests for delays constitutes **a double of the basic interest rate of a lombard credit increased by 2%, and it cannot be lower than 8%**. In accordance with the above principle, the current basic rate of interests for delays in force **amount to 12% p.a.**

However, the rules of applying a lowered rate were not subject to changes – it still amount to 75% of the basic rate. Taking into account the increase in the basic rate, from 9 November 2010 the lowered rate constitutes 9% p.a.

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