

Tax Newsletter



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Dear Sirs,

I am pleased to inform you that from 1 February 2011 Kinga Baran, tax advisor and experienced expert in the field of VAT, and Paweł Skwarek, tax advisor experienced in the scope of insurances and financial products, joined the Tax Advisory Department of Mazars.

The current edition of Tax Newsletter is largely dedicated to practical aspects related to changes in the scope VAT - including the issues resulting from taxation of free of charge giving out of goods, free of charge provision of services and re-invoicing of services exempted from VAT. In the months to come, we will draw your attention to new, emerging in practice, problems resulting from changes in the VAT regulations.

We also comment for you on the resolution of the Supreme Administrative Court of Poland composed of seven judges, concerning the treatment of expenses related to the increase in share capital (share issue).

In connection to many questions concerning changes in the scope of VAT and their practical implications, we will organise shortly a tax conference concerning VAT, of which we will inform you in details via our internet website.

I invite you to read the newsletter!

Krystyna Szydłowska

EDITORIAL

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Changes in VAT – selected current problems

Re-invoicing of services exempted from VAT

Since 1 January 2011 the scope of most exemptions from value added tax has been limited. Now, benefiting from the hitherto available exemptions which were of objective nature (for example in the scope of health care and education) depends also on who provides a given service (similarly to the way it took place in the previous years in relation to the services provided by Poczta Polska). In the case of services in the scope of medical care, these services, for the purpose of benefiting from an exemption, are to be carried out by health care institutions (both public and private) or provided within the sole medical practice. *Ipso facto*, the company which purchases a medical service from such entity, will receive an invoice with exemption from taxation. But if a company wants to transfer the costs of these services to its contractors or employees (for example when buying flu vaccines), it will not be sure which type of invoice should be issued, since applying of exemptions in case of a re-invoice is related to a significant tax risk. Taxation of this service by the rate of 23% is however unprofitable and can, on the other hand, negatively influence the invoice recipient's right to deduct the input tax (the right to lower the VAT is not applicable if a given service is exempted from taxation and the VAT was not included on the invoice).

The problem in question is to be solved by the next amendment of the VAT act, which exempts from the tax the provision of services in the scope of medical care, if these services were acquired by a taxpayer in his own name, but for a third party, from health care institutions and doctors. The amendment is to enter into force from 1 January 2011 to 31 March 2011 (i.e. retroactively).

Payment for perpetual usufruct of lands – problem with the application of a proper VAT rate

Letting the land for perpetual usufruct (most often by a municipality) on the grounds of the value added tax constitutes a provision of goods (and not services). The tax obligation in this scope is regulated in line with specific principles and arises at the moment of receiving the payment, not later than at expiry of the period for payment, which falls on March in relation to specific annual payments. As from 1 January 2011 however, the rates of value added tax have been raised, thus the regulation stipulate clearly which VAT rate should be applied. It is then pointed out that the proper rate is the one as of the day of carrying out a given activity and not as of the tax point. The annual payment is however collected for letting the lands for perpetual usufruct, that is an activity which took place, as a matter of principle, before 1 January 2011, when lower VAT rates were applicable. *Ipso facto*, it should be still taxed by the rate at the amount of 22% and not 23%. On the other hand, it should be noted that perpetual usufruct usually lasts for a long period of time (99 years) which would mean that the municipality should still charge the taxpayer with the payment rate of 22% until the end of this period, that is also in the next years in which theoretically this rate should not exist (it is replaced by the 23% rate). Furthermore, the regulations governing the rise of payment amounts for perpetual usufruct lack the basis for increase in the payment, since the value of land under perpetual usufruct itself does not change. Consequently, the taxpayer who will

receive in March 2011 the invoice for payment on the grounds of perpetual usufruct (with 22% or 23% rate) from the municipality, will not be sure if this invoice was issued in a proper way.

Free of charge provision of services – planned changes as of 1 April 2011

At present, the taxpayer issues an invoice for an internal service which he or she carried out free of charge only in the case when this service is not related to the business activity that he or she is running (for example it serves his/her or employees' purposes) and, at the same time, he or she is entitled to the right to deduct the input tax. However, unfavorable changes are being planned in this scope. If the project of the amendment concerning the value added tax act does not change, then the free of charge provision of services will be subject to taxation even when the taxpayer is not entitled to the right of deducting the input tax. It means that in almost every case when the employer purchases a third-party service for the benefit of an employee (for example a swimming pool pass) and it does not constitute a tax deductible cost due to the lack of relation with the taxed activity, and thus the VAT deduction is not inherent, such service will have to be taxed by the taxpayer as free of charge (obligation to issue an internal invoice).

Free of charge transfer of goods – projected changes as of 1 April 2011

At present, the free of charge transfer of goods is taxed only in the case when it is not related to the enterprise run by the taxpayer and the taxpayer is entitled to the right to deduct the input tax (for example giving a computer, which was previously used by the company's employee, as a donation for an orphanage).

As of 1 April 2011, a significant change is planned in this scope – free of charge giving out of goods is to be taxed in every case, regardless of its purpose, i.e. no matter if it occurs with (or without) relation to the activity run by the taxpayer. It means that, in a different way than at present, all giving out of goods connected with the conducted enterprise, i.e. for advertisement, promotion, premium, demonstration purposes, will be taxed (of course if the taxpayer is entitled to the right to deduct the input tax, which, in the case of giving out for the purposes related to the conducted business activity, is, as a matter of principle, obvious). Therefore, after entering into force of the new regulations the taxpayers will issue much more often the internal invoices, which, after all, will be in accordance with the European Union law. Consequently, a greater importance will be attached to the regulation (at present practically dead, as a free of charge transfer related to business activity is not taxed) according to which samples, presents of little value and printed publicity materials, based on exception rule, will not be subject to such taxation.

CIT – some share issue expenses constitute a tax expense (resolution of the Supreme Administrative Court of Poland)

According to article 15 section 1 of the corporate income tax act, the deductible costs shall be the costs incurred for the purpose of earning revenue or preserving or securing the source of revenues, with the exception of costs referred to in Article 16 section 1 of the act.

In the above regulation, enumerating the costs not treated as deductible expenses, the expenses for the increase in capital and for the issue of shares are not mentioned.

Therefore, the expenses incurred in relation to the increase in capital and to the issue of shares were not, on the grounds of the CIT act, directly excluded from deductible costs. Divergences in approaches, regarding the relation of such expenses with the tax income resulted in the emergence of two different opinions concerning their qualification as tax or non-tax costs.

The argument for the impossibility of qualifying share issue expenses as tax costs, presented by some tax authorities, consisted in adopting the position that such expenses do not show a direct relation with the tax revenue.

On the other hand, however, the majority of tax authorities pointed out that the revenue from the increase in capital is not a purpose in itself, since gaining a new capital is to serve the conduct and development of a taxpayer's business activity, that is potentially to generate revenues. Furthermore, an improvement of financial situation results for sure in securing the source of revenues.

In the recent years, administrative courts have been issuing resolutions which were unfavorable for taxpayers, by applying an argumentation analogical to the one of tax authorities. Due to the confusing position of administrative courts and two jurisprudences, i.e. the one allowing the recognition of tax costs on the grounds of expenses incurred in relation to the increase in capital and the one refusing this right, on 24 January 2011 the Supreme Administrative Court of Poland composed of Seven Judges passed the resolution (reference number II, FPS 6/10) which should change the approach of tax authorities to tax treatment of the expenses in question. **The Supreme Administrative Court of Poland stated that the expenses related to the issue of shares without which the whole operation would not be possible, shall not be recognized as deductible costs. However, other expenses which are not necessary (lawyers' and investment advisors' remunerations, costs of marketing actions) to carry out such issue, will be able to be treated as deductible expenses.**

Taken into consideration the fact that the expenses related to expert services, which are incurred in the case of share issue, constitute a significant part of expenses related to the increase in capital, this resolution may result in material tax benefits for listed companies (and not only – as the court clearly stated that not only listed companies are concerned).

Of course, despite the Supreme Administrative Court's resolution, in order for expenses in question to be treated as deductible costs, they should be considered in the context of general rule of tax qualification. These expenses have to be incurred for the purpose of earning revenue, preserving or securing the source of revenues. **The resolution will have for sure positive tax implications; however the assessment of their practical effects will depend to a large degree on the written justification of the judgment.**

EVENTS

We would like to invite you for thematic breakfasts and seminars conducted by Mazars tax experts:

- ➔ **9 March 2011 at 9.30-13:30, Mazars Office in Warsaw**
“Current Value Added Tax issues - changes for 2011 and latest project of amendment of the VAT Act”

For more information and registration: Emilia Biała, e.biala@mazars.pl, tel. 22 25 55 200

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Contact:



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

Tax Advisory Department
Mazars in Warsaw
Piękna 18 Street
00-549 Warsaw
Ph.: +48 22 25 55 200
E-mail: podatki@mazars.pl
www.mazars.pl



Kinga Baran
Manager
k.baran@mazars.pl



Paweł Skwarek
Manager
p.skwarek@mazars.pl

Tax Advisory Department
Mazars in Cracow
Wenecja 3 Street
31-117 Cracow
Tel.: +48 12 43 11 088
E-mail: podatki@mazars.pl
www.mazars.pl



Michał Galejczuk
Manager
m.galejczuk@mazars.pl



Przemysław Dybała
Tax Advisor (German Desk)
p.dybala@mazars.pl