

Tax Newsletter

NEWSLETTER Issue # 19 – October 2011

Dear Sirs,

In the current issue of our Newsletter we present changes in the settlement of foreign exchange differences effective from 1 January 2012 aimed at making the applicable regulations on this matter more precise.

I would like to recommend the commentary on the Civil Law Transactions Tax particularly to those of you who have sold shares in a limited liability company. Further, you will also find information concerning the approach to valuation and possible tax risk.

In reference to materials published in the September issue of our Newsletter we update you on the current status of the process of ratification of Double Taxation Avoidance Agreement with Cyprus (postponement of changes).

I hope you will enjoy this issue. At the same time I would like to remind you about the tax conference of Mazars on 27 October 2011 which will be devoted to VAT.

I am also pleased to announce the next conference which will be dedicated to transfer pricing and is planned for 23 November 2011. The details of this event will be sent in a separate correspondence.

Yours sincerely,

Krystyna Szydłowska

EDITORIAL

IN THIS ISSUE

- ➡ **CIT/PIT: Changes in the rules of determining foreign exchange differences** p. 2
- ➡ **Transfer pricing in the Special Economic Zone** p. 3
- ➡ **CLTT: How to value shares to be sold for the purpose of Civil Law Transactions Tax?** p. 4
- ➡ **International tax law: Double taxation – agreement with Cyprus** p. 5

CIT/PIT: changes in the rules of determining foreign exchange differences

On 1 January 2012 the Act amending the Act on Personal Income Tax and the Act on Corporate Income Tax will come into force. The main aim of implementing this regulation is to specify the existing rules concerning the appropriate exchange rate applicable to determining foreign exchange differences.

In the current legal framework, if the tax method of recognizing foreign exchange differences is applied, the regulations require to use the *actually applied exchange rate* in order to determine foreign exchange differences. This notion has not been defined by the legislator, however, in practice the actually applied rate is considered to be the rate of the bank running the account at which the given amount of money was translated.

In line with the corresponding regulations, if it is not possible to determine the actually applied rate (e.g. the account is run by a foreign bank that does not publish exchange rates), the exchange rate published by the National Bank of Poland shall be adopted to calculate foreign exchange differences.

The newly passed amendment to a certain extent specifies the existing regulations requiring to use the actually applied exchange rate in the following cases:

- Sale of foreign currency;
- Purchase of foreign currency;
- Receiving the amounts due;
- Payment of liabilities.

In other cases or if it is not possible to determine the actually applied exchange rate, the rate published by the National Bank of Poland shall be applicable.

Despite the fact that the adopted amendments are quite specific, it seems that part of controversy surrounding, for example, the exchange rate applicable to settlement of amounts due expressed in foreign currencies from the account maintained in the same currency will remain also in the new legal framework. Alas, it is difficult to predict what stance the tax authorities and administrative court will take on this matter.

The adopted amendment has also regulated the situation when a new entity is created following a division, merger or acquisition. The new entity will be allowed to opt out of the accounting method of determining foreign exchange differences regardless of its period of application. It will only be necessary to inform the competent tax office within 30 days.

Until now, opting out of the accounting method of determining foreign exchange differences was only possible after three years of its application starting from the fiscal year in which it was selected.

Transfer pricing in Special Economic Zone

Entrepreneurs who carry out business activity both within a special economic zone and outside this zone are under obligation to apply transfer pricing regulations to internal settlements.

In the event that an economic entity carries out activity both within a special economic zone and outside, article 11 of the CIT Act shall apply respectively to the internal settlements between entities from „within” and „outside” the zone. This obligation arises directly from § 5 sections 5 and 6 of the regulation of the Council of Ministers of 10 December 2008 on public aid to entrepreneurs operating based on the licence for carrying out business activity within special economic zone and was introduced in order to prevent zone entrepreneurs from applying the exemption also to income earned outside the zone.

As a consequence, the taxpayer who transfers goods or services produced in the zone for the activity carried out outside the zone or vice versa is obliged to value such transactions using transfer pricing methodology. The regulations do not impose on the taxpayer an obligation to apply a specific type of valuation because the methods defined by the tax regulations are binding only for tax authorities. However, it is important that the applied type of valuation complies with arm's length principles. This means that the entrepreneur should compare the conditions of internal transactions with the conditions of analogous transactions carried out with third party, and if no transactions with third party are effected – make a reference to settlements made in similar circumstances with independent entities. As a result of such comparison the market price appropriate for internal settlements will be determined. This stance is confirmed in interpretations of tax authorities, among others Ro/423/114/2005, BI/005-1107/04, ŁUS-II-2-423/253/07/JB, BI/4218-0011/05.

It should be emphasized that a taxpayer is not obliged to establish transfer pricing documentation for transactions carried out between entities from "within" and "outside" the zone. However, gathering records to confirm the market nature of the conditions adopted for internal settlements is in the entrepreneur's interest. In this way, the entrepreneur minimizes the risk that the amount of income earned and costs borne as part of zone activity will be questioned by tax authorities.

CLTT: How to value shares to be sold for the purpose of Civil Law Transactions Tax?

The valuation of shares which differs significantly from its market value might lead to a tax surcharge along with default interest.

If a shareholder of a limited liability company decides to dispose of its shares by sale or by gift, it is crucial to ensure an appropriate valuation. The civil law stipulates that there is freedom to set prices for things or property rights but their valuation differing significantly from market value might have negative effects for the taxpayer.

In line with article 6 section 1 point 1 of the Act on Civil Law Transactions Tax (hereinafter „Act on CLTT“) the basis for taxation in the event of sale of a thing/property right is its market value and not the price at which the thing/property right was sold. At the same time, relevant regulations of the Act on CLTT indicate that the market value of the object of civil law transactions is determined based on average prices applied in the trade of things of the same kind and class, taking into account their location, condition and wear and tear, and in the trade of property rights of the same kind, of the date of transaction without deducting debts and charges.

At the same time, the Act on CLTT provides for special obligations for tax authorities in the event that, according to these authorities, the value of things or property rights sold adopted by the taxpayer does not correspond to its market value or the taxpayer has not determined the value at all. Then the tax authority requests the taxpayer to increase /decrease the market value of the object of sale or determine it in not less than 14 days after the receipt of request. If in this time the taxpayer does not give/ determine the market value of the object of sale, the tax authority will determine it relying on the opinion of an expert or appraiser's report submitted by the taxpayer. If the value determined by the expert differs by more than 33% from the value given by the taxpayer, the costs of the expert's opinion are borne by the taxpayer.

A similar rule for determining the taxation basis based on the market value of a thing or property right acquired by gift as well as the mode of action in the event that declared taxation basis differs from the market value of a thing is laid down in the Act on Inheritance and Donations Tax.

Having in mind the above, we may ask a question how to determine the market value if the shares in a limited liability company not being subject to stock exchange operations are subject to taxation, or more particularly whether this value should be determined based on the market or book value of the company's assets. In an attempt to answer the above question, conclusions resulting from the judgment of 24 February 2011 (ref. II FSK 1900/09) could be useful; the Supreme Administrative Court opted for auxiliary use of the accounting method for valuation of shares. In the opinion of the adjudication panel the price of a share reflects the value of corresponding company's assets and without the knowledge about the company's estate, its assets and liabilities, the market value of shares cannot be determined. Therefore, according to the court, the book valuation of assets is a good starting point for performing an analysis of a market value of shares.

International tax law: Entering into force of amendments to the Double Taxation Avoidance Agreement with Cyprus will be probably postponed

According to unofficial reports available recently with regard to the renegotiated agreement between Poland and Cyprus (we wrote about this agreement in the September issue of our Tax Newsletter), and despite the announcement of the Ministry of Finance that it will enter into force on 1 January 2012 (at the latest on 1 January 2013), the procedure of ratification of the agreement by the Cypriots may lengthen considerably. Such conclusions are drawn on the basis of the present practice of the Cypriot government with regard to countries which renegotiated terms and conditions of DTAA in the last years. These countries are still waiting for the Cypriots to ratify the previously signed agreements. As an example, the agreement with Ukraine which was in the same stage as Poland now has not been ratified by the Cyprus until now. Similarly, the agreement with Russia was initialled in 2009 but has not entered into force until present.

We will keep you informed about the progress of ratification of the agreement with Cyprus.

Events

We are pleased to invite you to business breakfasts and seminars conducted by tax experts of Mazars:

- ➡ **27 October 2011, 9.30 a.m.- 1:30 p.m., Mazars office in Warsaw, ul. Piękna 18**
“VAT: recent issues related to Tax on Goods and Services – along with presentation of amendments made and planned for 2011”

For more information and registration: Aneta Sadkowska, Business Development, phone no. 22 25 55 200, a.sadkowska@mazars.pl

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

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.

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