



Tax Newsletter



NEWSLETTER Issue # 21 – December 2011

Dear Sirs,

In the current issue of the Newsletter, as the holiday is getting closer, we would like to particularly recommend the subject of tax settlement of employee gifts. In our study we indicate the most tax effective forms of seasonal gifts.

Moreover, we make reference to the question of settling utilities costs in terms of VAT when renting premises, in line with recent interpretations.

We would also like to turn your attention to the important, though disadvantageous judgment regarding transfer pricing adjustments at the end of a fiscal year.

Las but not least, on behalf of Mazars Tax Advisory Department I would like to wish you all a Merry Christmas and a Happy New Year.

Yours faithfully,

Krystyna Szydłowska

EDITORIAL

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VAT: Settlement of utilities costs when renting premises – re-invoicing or rent component?

Recent interpretations of tax authorities show that all charges resulting from the use of premises by the lessee, i.e. gas, heating, water supply, sewage collection and waste disposal (or so-called utilities), should be treated as fees for lease and thus they should increase the amount of rent. Hence, these costs are subject to taxation at the rate appropriate for a complex service of lease of real estate (business premises) amounting to 23%. Only when renting residential premises for residential purposes the lessee could claim exemption from tax.

Tax obligation related to service charges accompanying the lease service would arise then in accordance with article 19 section 13 subparagraph 1 of the VAT Act, i.e. upon expiration of payment date specified in the lease agreement if the rent was not paid earlier.

The above means that utilities – according to tax authorities – should not be re-invoiced to the acquirer (separately from rent) – as practiced by most taxpayers until now.

When re-invoicing utilities to the acquirer, taxpayers applied respectively 8% or 23% VAT rate, however, in the light of recent tax authorities' interpretations, such practice should be deemed incorrect.

To confirm the position based on which taxpayers could continue to settle utilities costs by re-invoicing, a reference can be made to the judgment of the Supreme Administrative Court in Warsaw of 31 May 2011, ref. no. I FSK 740/10, according to which charges related to the use of premises by the lessee, including heating, water supply, sewage collection and waste disposal should be recognized in the taxable base as rent components related to the lease. However, the Court also stated that **their re-invoicing to the lessee is acceptable if it is stipulated clearly in the lease agreement concluded by the lessor and the lessee that these charges (in total or in part) are settled separately from rent.**

Therefore, we would like to draw your attention to the fact that if you want to continue to re-invoice utilities costs instead of adding them to rent, this should be clearly stated in the agreement (according to the above-mentioned Court judgment). If there is no such clause in the lease agreement, there is a risk that utilities costs will be considered as not subject to re-invoicing and that they should be treated as rent component.

CIT / Transfer pricing: Risks related to the adjustment of transfer prices at the end of a fiscal year

In its judgment of 26 October 2011 the Voivodship Administrative Court in Poznan called into question the possibility of making transfer pricing adjustment at the end of fiscal year (the so-called TP adjustment).

This issue arouses major controversy among taxpayers. Doubts occur in particular with respect to the possibility of making a one-off TP adjustment for the whole year. In other words, a question arises **whether taxpayers can make an adjustment of income or costs for the entire year at year end in order to achieve the pre-established profitability** (transaction profit) and by the same token decrease or increase their income.

Statement of facts

The case concerned a car manufacturer. Cars were sold to the related entity. The Parties agreed that the sales profitability of the manufacturer should amount to 3.4% per year.

The profitability was calculated on the ongoing basis, however based on historical not actual data (periods from January to the penultimate month preceding the calculation month were taken into account). As a consequence of such calculation, at the end of the year deviations from the expected profitability could occur. In other words, actually achieved profitability could be:

- Higher than expected (higher profitability of the manufacturer),
- Lower than expected (lower profitability of the manufacturer).

In this context, the Company envisaged the possibility of adjusting deviations by making a one-off adjustment, respectively:

- Through payment (or de facto reimbursement to the acquirer) of part of the amount in order to decrease profitability,
- Through receiving from the acquirer an extra payment in order to increase profitability.

With a view to confirming the correctness of adopted settlement principles the Company applied for individual tax interpretation.

The Director of Fiscal Chamber in Poznan in his reply to the application issued two interpretations, of which one defines tax consequences regarding CIT and the other one refers to the possibility of recognizing the adjustment in a summary correction invoice.

In the interpretation regarding CIT settlements **the tax authority called into question the possibility of settling *in minus* adjustment** (i.e. decreasing the actual income). At the same time the tax authority considers that ***in plus* adjustment will generate taxable income**.

The tax authority found that the expenses that the Company would have incurred as a result of sales adjustment to achieve the target profitability level so that at the end of 2011 the profit level of the Company would correspond to the value established in the calculation process would not constitute tax deductible costs for the Company (in accordance with article 15 section 1 of the CIT Act), nor would they constitute an adjustment (decrease) of income in accordance with article 12 section 3 of the CIT Act.

In the second interpretation tax authority stated its opinion on the possibility of making adjustment of income for the entire year 2011 through one correction invoice. This interpretation concerned only the technical aspect of the adjustment. In line with the interpretation, **the Company can issue one summary correction invoice in order to achieve the predefined profitability level**. Nevertheless, for the purpose of income tax the conclusions arising from the first quoted interpretation remain effective i.e. the conclusions on the inadmissibility of *in minus* income adjustment.

Judgment of the Voivodship Administrative Court

First of the quoted interpretations according to which the tax authority considered the taxpayer's position as incorrect was appealed against to the Voivodship Administrative Court (WSA). In the judgment of 26 October 2011 (ref. no. I SA/Po 609/11), WSA in Poznan maintained the stance of the Director of Fiscal Chamber. WSA stated that cash received by the Company in consequence of sales adjustment with a view to achieving the target profitability will represent taxable income for the Company upon receipt of payment. In turn, expenses that would be incurred by the Company as a result of sales adjustment to achieve the target profitability level so that at the end of fiscal year 2011 the profitability level of the Company would correspond to the value established in the calculation process will not be tax deductible for the Company nor will they decrease income. In other words, *in minus* adjustment does not affect Company's tax settlements regarding CIT.

Conclusions

Despite the fact that both the interpretations and the judgment concern individual cases of taxpayers, the position they adopt may set a dangerous precedent for taxpayers.

Let's bear in mind that in accordance with the position expressed in the above-mentioned interpretation ***in minus* adjustments are not taken into account in the tax settlement, i.e. do not reduce the taxpayer's income**. Therefore, in case of control, the risk of questioning such adjustments by the tax authority is considerable. Hence it is recommendable to review transactions with related entities and change the adjustment methods, if any, to reduce the discussed risk.

CIT: necessity of proper documentation of expenses for purchase of intangible services

Gathering proper documentation is necessary to charge expenses for purchase of intangible services to tax deductible costs. Invoice and contract alone may be deemed insufficient by tax authorities to prove the fact that intangible service were actually provided and even more that the advantages gained by the beneficiary justified the purchase of this kind of services.

The CIT Act does not provide any definition of “intangible services”. **In practice this notion is understood as all kinds of performance that do not take tangible form.** In this sense intangible services include advisory and accounting services, market research, legal services, advertising, management, data processing, staff recruitment and sourcing, guarantees and sureties and other services of similar nature.

Expenses incurred with respect to intangible services can be in principle treated as tax deductible costs under general rules set out in article 15 section 1 of the CIT Act, i.e. when these expenses are aimed at achieving, securing or maintaining the source of income. However, a direct link between the expense and the income is not necessary – it means that the fact of incurring an expense does not have to be linked to any specific income.

The possibility of charging expenses for intangible services to tax deductible costs is not in principle questioned by tax authorities, provided that the taxpayer can demonstrate their relationship with his business activity. **Tax authorities more and more often request material proofs that such services were actually provided and that they were related to taxpayer's activity.** It frequently appears that presentation of invoice documenting the purchase of services in question or even the contract for provision of such services is not a sufficient proof (individual interpretation of the Director of Fiscal Chamber in Poznan of 16 September 2009, ref. no. ILPB3/423-474/09-4/DS). Such opinion is also shared by administrative courts (the judgment of the Supreme Administrative Court of 8 November 2011, ref. no. II FSK 1048/10, judgment of Voivodship Administrative Court in Lublin of 18 February 2011, ref. no. I SA/Lu 830/10).

It must be underlined that intangible services are often the subject matter of transactions effected between related parties. When effecting such transactions taxpayers have to take into account the increased control of tax authorities in this area. Settlements regarding intangible services attract close interest of tax authorities not only from the point of view of transfer pricing regulations but also because of the possibility of qualifying expenses incurred with respect to intangible services as tax deductible costs. In order to reduce the potential risk of dispute with tax authorities, it is recommended to assure additional documents confirming the provision of intangible services. Such proofs may include reports or protocols of activities carried out, expert's reports and analyses as well as photo or video documentation, press information that can prove, for instance, the provision of advertising or marketing services. It has to be mentioned that Tax Ordinance does not provide a closed list of proofs. Therefore anything can serve as proof if it can help to explain the matter and is not illegal.

In the light of the recent judgments quoted in this article, we would like to encourage you to verify the source documentation you hold and to complete it possibly before the end of the year when most of you has to proceed to final tax settlements.

PIT and social security on gifts to employees

In the holiday season many employers traditionally give seasonal gifts to employees. As a general rule, the value of gifts offered free-of-charge constitutes an income resulting from employment relationship subject to PIT and being the basis for calculating social security contributions (ZUS). However, depending on the nature of gift and its source of financing the obligation of paying tax and social security can be avoided.

In accordance with article 21 section 1 subparagraph 67 of the PIT Act the value of benefits in kind and benefits in cash received by employees in connection with the financing of social activity specified in the regulations on the Employee Benefit Fund, financed in full by the Employee Benefit Fund or Labour union funds up to the amount not exceeding **PLN 380 in a fiscal year** are exempt from tax. However, coupons, vouchers and other cards that enable to exchange them for goods or services are not considered to be benefits in kind for the purpose of the above exemption. Therefore, for a gift given to an employee to be exempt from tax, the following conditions must be met:

- The purchase of gift must be financed in full by the funds of the Employee Benefit Fund – the purchase cannot be financed by current funds of the employer;
- Handing over of the gift is made as part of employer's social activity conducted in accordance with principles set out in the Act on the Employee Benefit Fund (based on these principles, social activity is defined as for example, granting financial aid – in kind or in cash and this aid shall be distributed according to social criteria);
- Gifts are considered benefits in kind and do not include vouchers, coupons and other cards entitling to exchange them for goods or services.
- Total value of benefits exempt from tax does not exceed the amount of PLN 380 in a fiscal year. Any potential surplus above the specified limit is taxable.

The above means that upon giving to the employee the popular vouchers that can be exchanged for goods in a given outlet the employer should add their value to the employee's salary and deduct the output tax. Face to doubts as to the correct qualification of certain benefits as tax-exempt in-kind benefits in accordance with article 21 section 1 subparagraph 67 of the PIT Act, **in practice it may appear far more advantageous to give to an employee a cash benefit related to the approaching holiday.** If the value of the benefit received by the employee is dependent on his/her financial situation, its value will be exempted from PIT subject to the annual limit (i.e. PLN 380).

At the same time, in accordance with article 21 section 1 subparagraph 67 of the PIT Act giving to an employee a prepaid card (gift card) is considered to be a cash benefit; the card as a banking product is a type of debit card issued without the need of holding a bank account – the card entitles

its holder to make a payment after the card is credited. The accuracy of the above opinion is confirmed by tax authorities in individual interpretations (individual interpretation of the Director of the Fiscal Chamber in Poznan of 15 March 2011 ref. no. ILPB2/415-1419/10-3/JK, individual interpretation of the Director of the Fiscal Chamber in Warsaw of 4 October 2010, ref. no. IPPB4/415-551/10-4/MP). Thus, **as an alternative to holiday gift employers can envisage giving gift cards, the value of which would be exempt from Personal Income Tax** provided that the conditions specified in article 21 section 1 subparagraph 67 of the PIT Act are met.

International tax law: entry into force of agreements with the Isle of Man

We would like to inform you that the tax information exchange agreement between the Republic of Poland and the Isle of Man came into force on 27 November 2011.

The agreement signed on 7 March is the basis of bilateral exchange of information held by the banks, thus allowing to efficiently verifying the declared taxation bases of Polish taxpayers who derive profits in consequence of relationships with the Isle of Man and hold cash on the bank accounts opened in the Isle of Man.

The Agreement with the Isle of Man is the first agreement of this kind concerning the exchange of tax information with a jurisdiction included on the list of countries/territories offering unfair competition. The Ministry of Finance plans to sign other such agreements with Jersey and Guernsey and then with the Principality of Monaco, Gibraltar, the Cayman Islands, the Principality of Andorra and Grenada.

We would also like to remind you that the agreement between the Republic of Poland and the Isle of Man for the avoidance of double taxation with respect to certain income of individuals (income from wage work and retirements) as well as enterprises operating ships or aircraft in international traffic entered into force on 28 October 2011 (effective from 1 January 2012).

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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