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Changes in transfer pricing:

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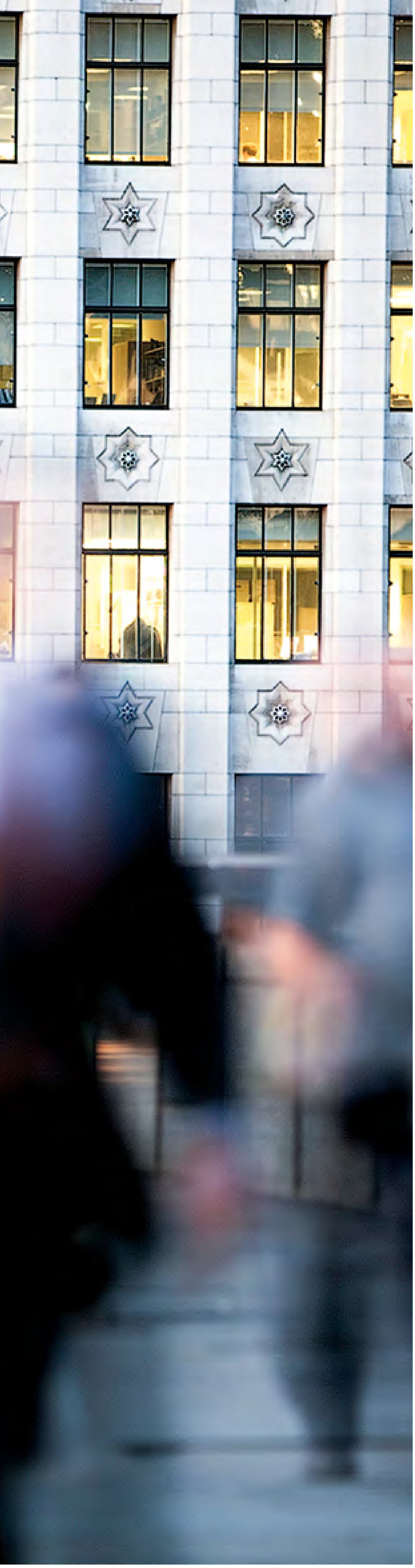

In this issue

Introduction

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New regulations on documenting related party transactions came out only last year. Considering the advances of OECD within the BEPS initiative framework, this was inevitable. In practice, the new regulations will come into force in the year 2017 only, yet they have already generated a lot of concerns among taxpayers. The change these provisions introduce is material. The previously required documentation called for much less information and much less effort on the part of the entities preparing it. The new documentation will be more extensive for many taxpayers and often demand presentation of previously undisclosed data.

In this issue of the Frontiers in tax magazine we discuss the new regulations for you, present their background and bring out additional aspects of the new tax documentation, including the added reporting obligations. We expect this can help you to systematically prepare for the challenge of the new obligations and to avoid being caught unawares by the new realities.

And then, there is the good news that for some of the taxpayers the new regulations will mean fewer responsibilities. The threshold for recognition of capital ties, which impacts the definition of related entities, will now be raised from 5 to 25%. Thus, the transfer pricing rules and the documentation requirements will no longer apply to those with lower equity holdings. The obligation to document will apply to transactions of a specific materiality level, which in the case of the larger taxpayers may mean fewer transactions to document than before. The smaller taxpayers also have reasons to be happy: the tax documentation will be required only once the EUR 2 million revenue or cost threshold is exceeded.

I wish you a pleasant reading.

BEPS Action Plan

The Base Erosion and Profit Shifting project (or BEPS) introduces, among others, new transfer pricing documentation rules and revises the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The BEPS recommendations are not just the next step in countering tax avoidance. They are of practical importance to the rules of related party transaction settlement.

Origin

At the initiative of the Organisation for Economic Co-operation and Development (OECD) and G20, since July 2013 many countries have pursued actions aimed at countering the phenomenon of tax base erosion and profit shifting, now commonly referred to as BEPS. The term BEPS points to the strategy of tax planning, one undertaken for the sole purpose of exploiting the loopholes and discrepancies in the respective countries' tax legislation to conceal or transfer profits to places in which the taxpayer exhibits little or no activity, nonetheless benefits from preferential treatment. This results in unduly low taxation or lack thereof. A plan of 15 actions described as the BEPS Action Plan was developed in order to overcome those negative phenomena. The final BEPS Action Plan reports were published on 5 October 2015. From that moment on, countries have proceeded with transposition of these actions to national regulations and coordination of the international actions.

In spite of the fact that the BEPS reports formulate recommendations, which can be considered soft law only, the OECD/G20 proposed standards are being adopted by the countries who opted to participate in the project, among them Poland. To date, Poland has introduced amendments that tighten up the regulations on thin capitalisation, the regulations on taxation of those resident in Poland on account of their shareholdings in controlled foreign companies (or CFCs) and the regulations aimed at countering the use of hybrid instruments for obtaining additional tax advantages.

BEPS Action Plan

1. Address tax challenges of **the digital economy**
2. Neutralise the effects of **hybrid mismatch arrangements**
3. Strengthen **controlled foreign company** (CFC) rules
4. Limit base erosion via **interest** deductions and other financial payments
5. Counter harmful tax practices more effectively, taking into account **transparency and substance**
6. Prevent **treaty abuse**
7. Prevent the artificial **avoidance of permanent establishment status**

8&9. Assure that **transfer pricing** outcomes are in line with value creation – Intangibles & Risks and capital

10. Assure that transfer pricing outcomes are in line with value creation – Other high-risk transactions
11. Establish **methodologies to collect and analyse data** on BEPS and the actions to address it
12. Require taxpayers to disclose their aggressive tax planning strategies arrangements
13. Re-examine **transfer pricing documentation**
14. Make **international dispute** resolution mechanisms more effective
15. Develop a **multilateral instrument** for implementation of the Action Plan on BEPS and modification of the existing double taxation treaties

Source: KPMG's executive summary

New transfer pricing documentation concept

Many of the BEPS Action Plan driven changes pertain to related party relations. One of those changes includes the new, three-stage transfer pricing documentation concept (just implemented into the Polish tax regulations) stipulated in action 13 of the BEPS Action Plan. The concept is based on subdivision of the documentation into: the local file (required from the largest group of taxpayers), supplemented with the master file that contains information about the capital group the taxpayer operates in (required from larger operators) and special Country-By-Country reporting (required from the largest international groups). Moreover, unlike in the previously binding transfer pricing documentation regulations, the local file needs to include a comparative data analysis which can demonstrate that the applied prices (profit margins and levels) meet the arm's length standard, in other words, are set at levels acceptable to unrelated parties.

Revisions to the OECD Guidelines

In order to assure that transfer pricing outcomes are in line with value creation, pursuant to the proposed actions 8, 9 and 10 of the BEPS Action Plan, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations will be amended accordingly.

The amended OECD Guidelines will cover such issues as: application of the arm's length pricing principle, commodity transactions, intellectual property, low value-adding intra-group services and cost contribution arrangements.

The OECD Guidelines do not form part of the Polish legal system, however, as a member of OECD Poland has committed itself to observe the recommended standards. The OECD Guidelines constitute the universally accepted source of interpretation and understanding of transfer pricing regulations. In practice, they are the benchmark for the courts, tax authorities and taxpayers, who can invoke them and interpret local regulations against them. Additionally, they provide guidance in assessment of related party transactions.

All of the changes made to the content of the OECD Guidelines are going to have a real impact on resolution of transfer pricing related disputes.

Novel approach to intellectual property

The new definition of intellectual property offered in the BEPS action 8 distinguishes between the economic and legal aspects of intellectual property. According to the amendments to Chapter VI of the OECD Guidelines, performance of functions which increase the intellectual property value (i.e. development, maintenance, enhancement, building market recognition) should provide adequate remuneration for the entity that provides such functions. The legal owner, which provides only legal protection and trademark registration, is not entitled to all the returns from their use.

What is being introduced is a clear distinction between the economic owner, the one engaged in development of the intellectual property, and the legal owner, the provider of legal protection and trademark registration. This is very important in practice as it impacts e.g. the rules of payment and the levels of the royalty rates due to the legal owner of intangibles. Royalty rates should be assessed on the basis of real involvement of entities rather than of contractual terms.

Cost contribution arrangements

The final guidance also proposes a novel approach to regulation of cost contribution arrangements. It recommends that the value of the payments to be made under such arrangements be set in reference to the market value of the benefit received by recipient of the service rather than based on the costs incurred by the service provider.

Moreover, the recommendations distinguish between payments toward ongoing work (e.g. research and development work conducted under a specific agreement), which should be referenced to the value of the performed functions, and payments for the existing intellectual property and legal value (e.g. in the form of a patented technology), where the royalty rates should be set in reference to the potential benefit arising from subsequent use of a given technology.

Remuneration for risk taking and capital contribution

Revisions to Chapter I of the OECD Guidelines specify that risk taking related remuneration is due to the transaction counterparty which *de facto* takes decisions and controls the risk i.e. has the capability to finance the effects of that risk, and has the appropriate human resources capable of taking decisions on acceptance and bearing of such a risk. Here OECD once more points to the precedence of the economic content of transactions, i.e. their actual progress and engagement of the parties over the contract provisions. The OECD Guidelines also specify that an entity which supplies capital has a right to remuneration equivalent to risk-free rate.

In practice, we are advised to pay particular attention to actual transaction progress and involvement of parties operating within structures with limited risk, e.g. limited-risk manufacturers or distributors. Another group of transactions which the revised OECD Guidelines will impact are those involving intra-group funding and the level of fees to the funding providers.

Summary

OECD proposal presented in the BEPS Action Plan, now progressively implemented by the Polish government, introduces a new order, which both the taxpayers and the tax administration will need to adapt to. BEPS Action Plan stands for a change in the settlement rules, e.g. in the case of the development or the use of intellectual property, and a change in the cost contribution arrangements, for rejection of transactions which do not make business sense, as well as for the precedence of the actual progress of a transaction and its economic sense over its legal (contractual) form. From the standpoint of BEPS, the economic justification becomes the key element in assessment of the terms of related party transactions.

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Local file

The local file will replace the documentation previously required under Art. 9a of the Act on Corporate Income Tax ("CIT act"). In addition to the elements currently required under tax regulations, the local file will need to include additional data in a number of categories. Among all types of documentation obligations specified in the new regulations, the requirements to prepare a local file will apply to the greatest number of taxpayers, because the lowest value thresholds have been set for this type of documentation.

Two criteria of the mandatory local file preparation

The obligation to prepare the local file documentation arises at fulfilment of the following two criteria:

1) The scale of the taxpayer's operations

   The taxpayers whose revenue or costs, within the meaning of the accounting regulations, exceeds an amount in PLN equivalent to EUR 2 million in the year preceding a given tax year will be required to prepare the documentation.

2) Transaction value

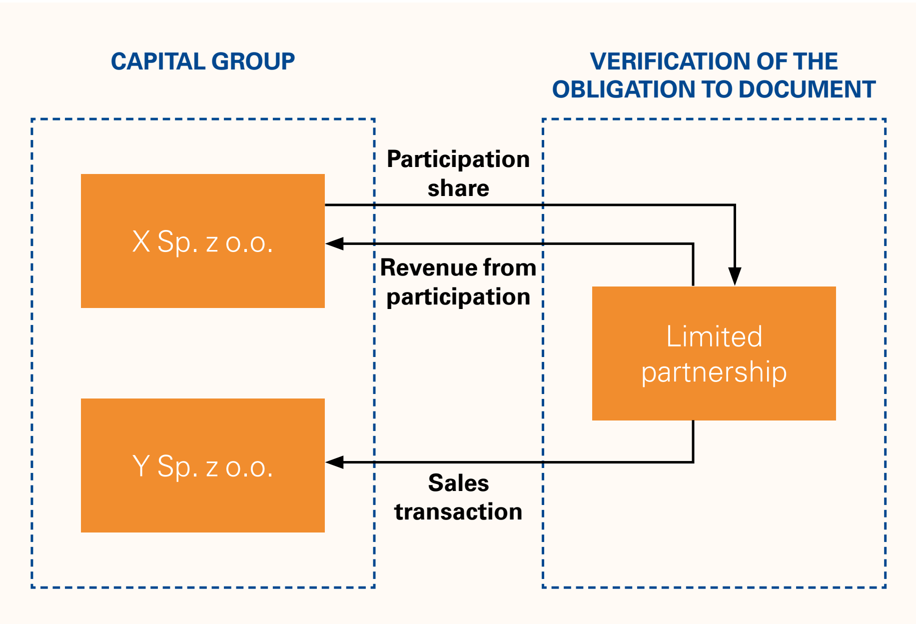
   The obligation to document will pertain only to a given tax year's transactions with the value exceeding the thresholds specified in the CIT act. The threshold transaction value will depend on the scale of each taxpayer's operations. The CIT act provides a detailed formula for calculating individual taxpayer's transaction materiality threshold and thus determining whether that taxpayer falls under the obligation of documenting its related party transactions. The minimum threshold has been set at an amount in PLN equivalent to EUR 50,000.

   EXAMPLE: The taxpayers with revenue equivalent to EUR 20 million in the year preceding a given tax year will be required to prepare documentation for the transactions exceeding the amount in PLN equivalent to EUR 140,000 in the given tax year while the taxpayers with revenue equivalent to EUR 100 million will need to report the transactions exceeding the amount in PLN equivalent to EUR 500,000.

Transactions of partnerships

The new regulations define the rules regulating the obligation to prepare documentation in the case of transactions concluded by the taxpayer's subsidiaries which are not legal entities. In this case fulfilment of the scale of operations criterion is verified in respect of companies which are not legal entities while the documentation itself can be prepared by a designated company partner domiciled in Poland.

EXAMPLE: X Sp. z o.o. generates revenue from participation in its limited partnership subsidiary, which makes sales to Y Sp. z o.o. Companies X and Y Sp. z o.o. form part of the same capital group. Whether the obligation to prepare documentation arises in that case will depend on fulfilment of the scale of operations condition by the limited partnership (as well as on the transaction value of the sales made by that company).



Documentation elements

As in the case of the documentation required under Art. 9a of the CIT act, the local file needs to include:

1) Indication of the nature and subject of each transaction.
2) Financial data, i.e. for each transaction category, specification of the transaction value as specified in an agreement or another document, invoices and effected payments.
3) Data which identify the related parties, i.e. disclosure of names and address data, with information on the nature of the relationship.

   The new regulations expand considerably the scope of the information required on the remaining elements specified in Art. 9a of the CIT act, but also introduce a number of completely new elements. The local file must also include:

4) Description of the transaction process, i.e. disclosure of the performed functions, the engaged balance sheet and off-balance sheet assets, and human resources, and the risks borne, including discussion of the changes which occurred in these compared to the previous tax year.

   It is for the first time that off-balance sheet assets are specified as an important documentation element. Another new element is the requirement to include in the functional analysis the changes which occur compared to the earlier tax year.

5) Specification of the method and the manner in which the taxpayer's income (loss) was calculated, together with justification of those choices, and including the algorithm used in calculation of the mutual settlements and the manner in which the settlement values impacting the taxpayer's income (loss) were calculated.

   Justification of the choice of the calculation method and presentation of the calculation algorithm were previously non-compulsory nonetheless recommended elements of the documentation. The new requirement should be understood as the obligation of presenting in detail how the transaction price was calculated. For many taxpayers this may prove cumbersome as it may be difficult for some of them to access such detailed data.

6) Description of the taxpayer's financial data, which allows comparison of the payments the transactions provided for with the data disclosed in the approved financial statements.

   The above requirement should be understood as an obligation to demonstrate the price calculation approach in reference to the taxpayer's accounting data. That is a new documentation element aimed at facilitating the tax authorities' task of establishing whether the declared method is being applied in practice as well as at inculcating in the taxpayers the habit of self-assessment for correctness of the settlement accounts.

7) Taxpayer information, including the description of: their organisational and management structures, the object and scope of operations, the pursued business strategy (including any restructuring transactions in the documented and the previous period), and the competitive environment.

The new regulations define the rules regulating the obligation to prepare documentation in the case of transactions concluded by the taxpayer's subsidiaries which are not legal entities

8) Documents, including transaction related agreements and transnational arrangements relating to income tax, particularly any prior price agreements.

Documentation submission time limits

Consistent with the previously binding rules, the period running from the date of the documentation file request receipt and the date of its submission will be limited to 7 days. In addition, the tax authorities will be entitled to demand presentation of documents for transactions of value which does not exceed the statutory limits. They will be able to apply this measure whenever the circumstances indicate the probability that the transaction value is being understated with the aim of avoiding the obligation to prepare documentation. Under such conditions, relevant documentation will need to be delivered within 30 days of the request service date.

Summary

On the one hand, by introducing the taxpayer revenue threshold and increasing the transaction value thresholds, the new regulations limit the number of the taxpayers and the number of the transactions that fall under the obligation to document. On the other hand, however, the scope and the degree of detail of the information which will need to be disclosed in the documentation are being expanded in a significant way, which increases the burden for the taxpayers as well as increasing their risk in the course of an inspection.

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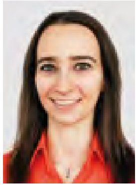

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Benchmarking analysis, a new element

As of the year 2017 the taxpayers whose revenue or costs exceed a specified threshold will be required to add one extra element to their tax documentation: benchmarking analysis. Such an analysis is prepared for the purpose of confirming that the prices applied in transactions with related parties are consistent with the arm's length principle.

Those who this change concerns

As of 2017, the taxpayers whose revenue or costs in the year preceding the year in respect of which the tax documentation is being prepared exceed an amount equivalent to EUR 10 million will be under the obligation of preparing benchmarking analysis. Analogous obligations are imposed on the taxpayers holding shares in companies which are not legal entities (e.g. a civil, general or limited partnership) whose revenue or costs exceed the aforementioned threshold.

Benchmarking analysis will form an integral part of the local file prepared by such a taxpayer for each material transaction, i.e. one which exceeds a duly determined threshold which will not be lower than EUR 50,000 and which increases with an increase of the taxpayer's revenue for the previous year. Up to now this analysis was prepared on voluntary basis, with the aim of limiting the risk of having the legitimacy of the applied prices called into question and for the purpose of determining arm's-length settlement conditions.

principle, i.e. that the prices set in the analysed transactions would have been acceptable to unrelated parties operating in the market under comparable conditions.

In accordance with the published amended Act on Corporate Income Tax, which will enter into force on 1 January 2017, a completed benchmarking analysis intended to verify the terms adopted in the analysed transaction should involve:

- a comparison between the terms of the analysed transaction and the terms adopted by the party to that transaction in a comparable transaction it concluded with an unrelated party, i.e. an internal comparison or
- performance of the analysis with the use of data on comparable transactions concluded by unrelated parties in the market, i.e. an external comparison.

It should be noted that the legislator points to the obligation of performing the exercise – in the first place – on the basis of data relating to the Polish market. Though the new CIT act does not provide for adoption of such a solution directly, we can anticipate that it will be possible to use data of foreign entities in the analysis if the data available locally proves insufficient.

However, whenever data on comparable economic events cannot be acquired then, pursuant to Art. 9a of the CIT act, the tax documentation needs to be supplemented with an assertion describing how the transaction terms are consistent with terms unrelated parties would have agreed on. This provision should be understood as a requirement to present relevant studies that demonstrate that the adopted pricing method is consistent with the commonly used pricing methods (e.g. discounted cash flow based pricing).

Information to be included

The constituent elements and information which benchmarking analysis needs to include have been presented in the Draft Regulation on the detailed description of the elements that make up the tax documentation. It should be borne in mind that, in contrast to provisions of the new CIT act, the content of the Draft Resolution is still subject to change. Notwithstanding this, according to the now published language of the aforementioned Draft Resolution, benchmarking analysis should, among others:

- specify the party of the examined transaction, the characteristics of the compared goods or services, the delivered quantity, the type and form of the transaction, and in the case of intangible assets – the description of anticipated benefits accruing from use;

The constituent elements and information which benchmarking analysis needs to include have been presented in the Draft Regulation on the detailed description of the elements that make up the tax documentation

Purpose of the benchmarking analysis

The benchmarking analysis taxpayers will prepare is intended to confirm that the terms applied in the transactions they conclude with related parties comply with the arm's length

- refer to the economic conditions in the sector which the taxpayer operates in;
- provide a justification for the use of multi-year comparative data, and whenever the taxpayer uses for price calculation purposes data on business transactions concluded with an unrelated party, those data must be included in the analysis;
- include the financial indicators applied in the revenue (loss) calculation method for the related party transaction and for transactions with unrelated parties;
- specify any adjustments made for the purpose of eliminating possible differences between the examined transactions to achieve comparability of the analysed transactions.

Deadlines

Benchmarking analysis forms part of the local file. As a result, it must be delivered to the Tax Authorities within 7 days as counted between the request delivery and the file submission dates. Additionally, due to the fact that the new regulations introduce the obligation to submit a representation on completeness of the prepared local file together with the annual tax return for a given year and in light of the fact that benchmarking analyses constitute a mandatory element of the local file, the concerned taxpayers need to prepare relevant studies within 3 months of the tax year end.

In contrast with the tax documentation itself, benchmarking analysis updates can be prepared once in three years. What constitutes an exception is a change is the economic conditions that can have significant impact on the results of conducted analysis. In such a case, the update should be prepared in respect of the year in which the change occurs.

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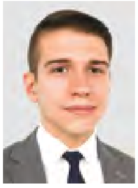

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Master file, additional obligation for large entities

The year 2017 will bring significant changes for taxpayers with large scale operations, whose revenue or costs in the year preceding a given tax year exceed EUR 20 million. Those taxpayers will have to prepare not only a local tax documentation file with comparative analyses, but will also be required to prepare every year a group documentation (so called "master file"), containing information file on the group in which they operate. The same obligation also applies to the taxpayers holding shares in companies which are not legal entities whenever revenue or costs of the latter companies exceed EUR 20 million in the previous financial year.

What is the purpose of yet another documentation obligation?

Master file is primarily intended to help tax authorities to better assess the transfer pricing risk. With access to broad ranging and comprehensive information about a given capital group, tax auditors should be able to perform the transfer pricing audit of an entity in Poland more effectively, in other words, to assess whether the taxable income amount, which a given entity should have declared in compliance with the arm's length principle, had indeed been set correctly.

The use of readymade master files

When preparing information about the group, the taxpayer should first specify the entity which prepared the master file (typically the parent company) and present information on that entity's time limit for submission of its tax declaration. Thus, pursuant to the new regulations, the obligation to prepare information about the group applies to both the parent entity and its subsidiary, which may use the documentation prepared at the central level in order to fulfil its local obligation. Such documentation should be made accessible to all entities of a group. The new regulations are expected to improve subsidiaries' chances of obtaining in a timely manner the master files their parents prepare, which had previously not been easy in case of some capital groups.

What should a master file include?

In order to facilitate the tax auditors' task of assessing whether income is being allocated between entities of a capital group in a correct way, the legislator provides for a broad range of information which should be presented in the master file. This includes:

1) The description of the legal, ownership, management and geographical structure of the group the related parties constitute.
2) The group transfer pricing policy or primarily the description of setting the remuneration, particularly for such transactions as:
   - provision of group services, often referred to as "management services";
   - research and development services;
   - sharing of intangible assets (e.g. trademarks);
   - financing of operations, e.g. granting loans and guarantees, concluding of agreements on liquidity management, etc.
3) The description of the subject of business activity of the group, including:
   - the key factors affecting the level of profit (key success factors), competitiveness, market share, etc.;
   - information on the largest suppliers and customers, i.e. those largest in terms of revenue, product or service groups, and on products or services which represent over 5% of the group's revenue (including the description of the geographical markets for those products or services);
   - a list of significant transactions related to services;
   - analysis of the key functions, risks and assets, which certain entities of the group contribute to the value chain;
   - the description of any reorganisations in the group involving the transfer of economically important functions and assets or risks as well as any mergers, acquisitions

When presenting information in a master file, the taxpayer needs to ensure consistency with the information presented in the local file as well as in the CIT-TP report and investments performed in the group in a given year.

4) The description of intangible assets the group uses; in this aspect extensively detailed information is required particularly on:

- group's strategy regarding preparation, ownership and use of intangible;
- a list of intangible assets in the group and a list of significant contracts or agreements related to intangibles concluded between entities of the group (e.g. joint ventures, agreements R&D services agreements and licensing agreements);
- information regarding changes of legal or economic ownership of intangibles or changes in the entities using intangible assets in a given year, including specification of any compensation paid out on that account.

5) The description of the group's financial condition, including information about the method of financing the group by independent entities and a list of loans and credits.

Worth noting is the fact that some of the required information is highly detailed and had previously not been included in the master files prepared by the group head offices pursuant to the recommendations of the effective OECD Guidance on Transfer Pricing.

When to prepare a master file?

It is worth underscoring that the additional representation on completeness of the prepared tax documentation file – which will be signed by the taxpayer's representatives as recorded in the National Court Register and appended to the annual tax return – does not provide for an obligation to include information on the prepared master file. Nonetheless, a master file should be prepared and appended to the local file no later than by the date of submission of the annual tax return in respect of a given year by the entity preparing the master file documentation at the central level. As in the case of the local file, the master file requested by tax authorities or tax audit authorities will also need to comply with the existing 7-day submission time limit.

Some useful advice

When presenting information in a master file, the taxpayer needs to ensure consistency with the information presented in the local file as well as in the CIT-TP report, e.g. in the scope of information on the restructuring processes which occurred in a given year, involving the subsidiary.

Given the wide range of the required information, the 7-day time limit may prove to be far too short for collection of all the required data within the group and for translation of that documentation into Polish (the entire tax documentation must be submitted to the auditors in the Polish language). Consequently, it is recommended to verify in advance what was prepared at the head office level and what type of information still need to be obtained pursuant to Polish regulations.

According to the guidance included in action 13 of the BEPS Action Plan, a master file may refer to relevant appendices without the need of providing their descriptions, provided however that their content is consistent with the scope of information required by local regulations. Assessment of the degree of details to be included in the presented data, should be consistent with the major purpose of the master file, which is to enable tax auditors to assess the transfer pricing risk.

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Country-by-Country reporting, a new reporting obligation

One of the effects of adoption into law of the amended Act on Corporate Income Tax ("CIT act") in the year 2015 has been the introduction of certain new documentation related obligations applicable to entities operating in capital groups. In addition to the Master File, documentation prepared from the vantage point of the entire group, and the Local File, documentation providing the country specific information, the legislator also introduced the Country-by-Country reporting ("CbC"), a detailed report on operations broken down into the respective tax jurisdictions in which a given capital group operates.

The obligation to prepare CbC reports stems from Art. 27 sections 6-9 of the amended CIT act. The model CbC report document will be set forth in a separate regulation. However, the relevant regulation has not been published yet, this in spite of the fact that the taxpayers will be required to prepare a CbC report in respect of the year 2016. We can presume, however, that the final draft of the regulation will be largely consistent with the draft released in the middle of last year.

Origin

The CbC reporting obligation has resulted from the recent amendment of the CIT Act, which is largely an outcome of a project initiated by the Group of Twenty and OECD to develop procedures and the concept of legal standards aimed at countering the phenomena of underreporting the tax base and shifting of profits to so-called tax havens by international capital groups (Base Erosion and Profit Shifting, further referred to as BEPS).

The rationale for introduction

CbC reporting is intended to provide capital group level aggregated information on income, tax paid and the scale of the economic activities conducted by entities in a capital group in the respective tax jurisdictions. CbC reporting aims to improve fiscal transparency of taxpayers through provision of detailed and adequate information on intra-group relations. In line with OECD's assumptions, CbC reporting – due to its comprehensive and homogeneous nature in each of the countries implementing it – is expected to remedy a significant issue faced by tax authorities of many countries – the abuse of transfer pricing. It is hoped that CbC reporting will increase the efficiency of the mechanisms of control and identification of irregularities as well as conducting tax inspections and audits, also through joint efforts of the local tax authorities.

The taxpayers the requirement applies to

Pursuant to the amended CIT Act, the obligation to prepare CbC reports will apply to entities that meet all of the following criteria:

- will be a parent entity and will not fulfil the criteria of a subsidiary;
- will consolidate their financial statements;
- will have foreign establishments and/or subsidiaries;
- the group's consolidated revenues in the country and abroad will exceed the equivalent of EUR 750 million in the previous tax year.

The aforementioned concepts should be understood in accordance with accounting regulations. The EUR 750 million threshold will be translated into PLN at the average exchange rate announced by the National Polish Bank prevailing on the last working day of the tax year preceding the tax year in respect of which a CbC report is submitted.

According to the estimates of the minister of finance, the number of Polish entities obliged to prepare CbC reports will be close to 20, but we also need to bear in mind that equivalent CbC reporting regulations are likely to come into force in many other OECD countries. This may extend the documentation obligation indirectly to smaller Polish taxpayers – members of capital groups whose parent companies are domiciled in countries also introducing the CbC reporting obligation. Such indirect documentation obligation should be understood to mean requests of foreign parent

The CbC reporting obligation has resulted from the recent amendment of the CIT act, which is largely an outcome of a project initiated by the G20 and OECD

companies to provide information they require to prepare CbC reports in their countries.

Form and content

The draft regulation of the minister of finance provides for the tabular format of the CbC report, this to ensure transparency and readability of the presented data. The data aggregated in tables will also facilitate subsequent use and analysis. A CbC report should be made up of three tables:

- In the first table the local entity will present information on the capital group's income, taxes and its economic activity broken by country or territory in which it conducts that economic activity. That information will be disclosed by countries in which the specified related entities are subject to unlimited tax liability.
- In the second table the taxpayer will need to disclose a list of the related entities which form a capital group. That information will be disclosed by country or territory in which the specified related entities are subject to unlimited tax liability or to limited tax liability in the case of foreign establishments. In addition, the taxpayers will specify the main economic activity of each of the entities forming part of their group.
- In the third table the taxpayer will have the space to submit additional explanations, in particular on any extraordinary or nonstandard situations, the nature of which could not be fully demonstrated in the aggregated (tabular) form of the two earlier tables.

In some aspects CbC reporting will involve disclosure of information that is confidential and strategic for the concerned capital groups, which is why the issue of subsequent exchange of information included in CbC reports between the domestic tax authorities raises concerns among many taxpayers.

Timeline

Taxpayers will be required to prepare a CbC report in respect of the tax year beginning after the date of 31 December 2015. A CbC report must be delivered within 12 months after the end of the tax year in respect of which the report is being submitted. The above implies that the first CbC report, one in respect of the year 2016, will have to be submitted by 31 December 2017. It is worth mentioning that the CbC reporting obligation will most likely come into force in many OECD countries in the same period (2016/2017).

The data exchange mechanism

Effective achievement of the goal of CbC reporting, i.e. that of ensuring greater fiscal transparency, with the resultant countering of BEPS related processes, will call for employment of effective mechanisms of co-operation between the respective tax authorities, which includes addressing the issues of sharing information disclosed in CbC reports by capital groups operating in respective countries. It is worth adding that 27 January 2016 marked the signing of the Multilateral Competent Authority Agreement on automatic exchange between its signatories of the information disclosed in CbC reports. The agreement was signed by 31 countries, among them Poland, Germany, the United Kingdom, France and Luxembourg.

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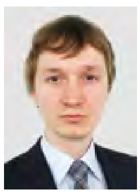

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Specialist of the Transfer Pricing Team

Additional taxpayer obligations

New regulations cover not only preparation of transfer pricing documentation in a new format, but also impose on the taxpayers additional reporting obligations, which include the representation on preparation of tax documentation and the CIT-TP report. We should also note that concurrent with the new regulations coming into force, the status of the transfer pricing issue rises as it is now within the remit of the Polish Ministry of Finance and of the European Union.

Representation on preparation of tax documentation

Pursuant to the new regulation, in addition to preparation of the previously described tax documentation, as of 1 January 2017 taxpayers are required to submit representations on preparation of tax documentation relating to transfer pricing. This representation will be mandatory to all the taxpayers required to prepare the said documentation, irrespective of the revenue or costs those taxpayers generate.

The timescales for submission of the representation provided for under the new regulations coincides with the timescales of filing the annual tax return. In practice this equates with the obligation to prepare the documentation within 3 months of the tax year end.

It should be underscored that the said representation will not apply to the master file. This is informed by practical concerns, namely the extended time it takes to acquire data from group parent entities.

The representations will be submitted by given entity's representatives as recorded in the National Court Register, which means that the attendant liability rests with the taxpayer's management.

The CIT-TP report

Moreover, the legislator also introduced to Polish regulations an entirely new report i.e. CIT-TP. The minister of finance has defined the model format for it in a draft regulation prepared on the basis of the guidelines which accrued from the work of the Organisation for Economic Cooperation and Development (OECD). The requirement to submit the CIT-TP report will become effective as of 1 January 2017.

The entities required to submit the new CIT-TP report are the taxpayers required to prepare tax documentation if their revenue or costs in a given tax year exceed the equivalent of EUR 10 million. Every taxpayer meeting the criteria indicated above should append a completed CIT-TP report to the tax return they are required to file within 3 months of the relevant tax year end. For the taxpayers whose tax year coincides with the calendar year, the deadline for this requirement falls on 31 March.

In its currently known draft form, the CIT-TP report will be made up of eight parts, including three primary elements:

1) Place and purposes of submission of the information (Section A);
2) Company identification data (Section B);
3) Signature of a person representing the company (Section H);

and further additional elements:

4) Indication of existing capital ties, including their type, nature and size. Disclosure if the entity

operates as an establishment of a foreign company or is an owner of such an establishment (Section C).

5) Information on the number of related parties with whom the taxpayer is trading and the countries from which they conduct their business. The data should comply with the ISO 3166 standard as defined by the International Organization for Standardization as a way of standardising the classification of countries by setting bytecodes, dependent territories and administrative units (Section D).

6) A group of topics relating to the main sector of activity and the functional profile. In this section taxpayers are required to demonstrate the nature of their business (i.e. production, trade, finance and insurance, or services). In the rest of the section the minister of finance requires a detailed presentation of the taxpayer's functional profile, with differentiation between a situation in which the taxpayer may be a distributor taking on limited risk or a distributor with extended functions and risks. A similar distinction is to be applied in the case of production functions, i.e. differentiation that takes into account comprehensive functional analysis: of functions, risks and assets (Section E).

7) Information on occurrence or initiation of business restructuring (Section F).

8) Detailed information on related party transactions. Here taxpayers are required to disclose the value of each transaction category by classifying them into groups of transactions with a value of: below EUR 10 million, within the range of EUR 10 to 50 million, and of over EUR 50 million. Here they should also indicate the countries in which the transaction parties have their registered seats (a reference to the ISO 3166 codes provided earlier). A list of transactions grouped generically, among others: sale of goods, expenses/revenue from rental and leasing, expenses/revenue from intra-group services, the acquisition of intangible assets, plus controlled financial transactions, including interest on receivables in cash pooling agreements and revenue/losses on guarantees issued. As an additional element, a list of financial information in which taxpayers are required to disclose the value of financial working assets and long term liabilities and receivables. In this report section taxpayers should also disclose information on their participation in cost sharing agreements or cost contribution arrangements (CCA).

Verification of prices in related party transactions, a priority of the Ministry of Finance for 2016

According to the communique of the Ministry of Finance of December 2015 entitled "Transfer Pricing – plans of the Ministry of Finance for the year 2016", one of priorities of the Ministry in the current year will be the verification of transfer pricing, i.e. prices of transactions between related parties. The communication is a corollary of the assumptions outlined in a document entitled " Action plan of the Minister of Finance for 2016", in which detection of significant irregularities which endanger the national security and protection of the interests and property rights of the State Treasury were given priority among the objectives of the Ministry for implementation in 2016 and which include, among others, prevention of income tax avoidance, with special emphasis on the use of transfer pricing.

In its communique of 18 December 2015 the Ministry of Finance noted that "often, in practice, the subsidiary pays the parent company (or another group entity) in excess of the market price for particular goods or services (e.g. the use of a logo or advisory services). [...] As a result of such practices the state budget loses out, as the company discloses the relevant invoice in its tax deductible costs and thus reduces its tax base and pays lower taxes to the state budget. By acting in such a way a company violates the regulations of the Act on Corporate Income Tax." In addition, the Ministry of Finance repeated that under Art. 81 par. 1 of the Tax Ordinance, taxpayers have the opportunity of correcting their tax declarations, without giving any reasons. According to the Ministry of Finance, "companies that opt for voluntary correction of the tax return, will benefit from a 50% reduction in interest on tax arrears". It should also be underscored that if a tax return correction is the result of a tax

The exchanged information is to be saved and stored in a secure central database, which the Commission will develop by 31 December 2017.

audit, such interest will be due in full. Consequently, the Ministry of Finance encourages the taxpayers who applied non-arm's length prices in transactions with related parties to make adjustments for the years 2011-2015 by the end of the first quarter of 2016. At the same time, the Ministry warns against executing before the end of 2015 of transaction aimed at reducing taxable income: "in relation to the practice of making transfers in the last days of a calendar year in order to reduce the declared income, the Ministry of Finance recommends the taxpayers to withdraw from such measures in the last days of December 2015." According to the communication, such activities will be examined in the second quarter of 2016.

The Ministry of Finance announced that in this regard it will use the experience gained from ongoing audits and allocate "resources for this course of action".

It is worth noting that according to "Action plan of the Minister of Finance for 2016", the Ministry plans, among others, to develop guidelines for a new draft law on Fiscal Control Bill intended to increase the effectiveness and adequacy of fiscal control in combating tax fraud and to ensure consistency between the fiscal control regulations and those of new Tax Ordinance.

Directive on the automatic exchange of information on advance tax rulings and advance pricing arrangements

On the basis of to the regulations adopted in the framework of the Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation, Member States to the European Union are required to provide each other with information they deem relevant to the application and enforcement of domestic tax legislation. However, the statistics submitted by Member States to the European Commission in 2014 suggest that this provision only marginally embraced exchange of information on advance tax rulings and advance pricing arrangements (APA). Moreover, in June 2014 the Commission announced that it has opened investigations to examine whether the advance tax rulings of the APAs issued by some Member States comply with EU state aid rules.

Accordingly, in March 2015 the Commission presented a framework for a new regulation on the exchange of information on advance tax rulings and APAs. An agreement on the introduction of an automatic exchange mechanism was reached at a meeting of the Economic and Financial Affairs Council (Ecofin) on 6 October 2015.

Under the Council Directive (EU) 2015/2376 of 8 December 2015 (amending the Council Directive 2011/16/EU), Member States are required to automatically exchange information about ex ante cross-border tax rulings and APAs issued, revised or renewed after 31 December 2016. The Directive specifies the scope of information to be exchanged; however, Member States have the right to request additional information. The exchange of information is to occur within 3 months of the end of each calendar half-year in which the advance tax rulings and APAs are issued, revised or renewed.

The exchanged information is to be saved and stored in a secure central database, which the Commission will develop by 31 December 2017.

Information about the advance tax rulings or the advance pricing arrangements issued, revised or renewed between 1 January 2012 and 31 December 2013 is also to be transferred, pursuant to the new regulation; provided that these were still in force on 1 January 2014. However, if the advance tax rulings or APAs were issued, revised or renewed between 1 January 2014 and 31 December 2016, then the obligation to provide information about them exists regardless of their validity period. Member States may unilaterally waive their obligation to transfer the advance tax rulings or APAs issued, revised or renewed prior to 1 April 2016 for small and medium-sized enterprises. The exchange of information within the framework described in this paragraph will take place before 1 January 2018.

It is worth noting that the adopted regulations are consistent with the direction and the effects of the work of the Organisation for Economic Cooperation and Development on countering tax base erosion and profit shifting (BEPS). OECD suggested, among others, mandatory, spontaneous and immediate exchange of information on six categories of advance tax rulings and APAs.

Member States are required to implement these regulations into national law by the end of the year 2016.

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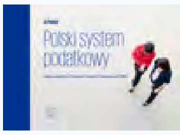
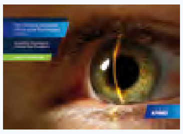
KPMG publications

The KPMG analyses and reports are an output of our expertise and experience. The publications take up issues important to enterprises operating in Poland and globally.



The Polish Tax System

The report presents the results of a study on the Polish tax system conducted on January 19th 2016 among the participants of the 6th KPMG Tax and Accounting Congress, ie. representatives of management, financial directors, chief accountants and heads of financial reporting and controlling. The study was designed to assess the Polish taxation system from the point of view of senior management of companies from various industries across Poland. The questions included in the study were answered by 178 participants.



The Changing Landscape of Disruptive Technology. Innovation Convergence Unlocks New Paradigms.

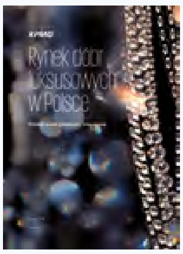
KPMG International conducted this study entitled "The Changing Landscape of Disruptive Technologies. Innovation Convergence Unlocks New Paradigms provides a three-year perspective on the global trends in the new technologies market. The study in August and September of 2015, with employment of the Computer Assisted Web Interview method on a sample of 832 leaders in technology representing 17 countries, including European states (UK, the Netherlands, Germany and Slovakia). The respondents included for the most part CEOs and board members (87%). Over half of them (64%) were large and medium-sized company representatives, with start-up owners forming 27% of the sample and 9% being venture capitalists.

The Automotive Industry, Q1/2016 Edition

The report is part of a series of quarterly reports presenting current trends in the Polish automotive industry, which covers the automotive market, the motor vehicle manufacturing industry and the automotive financial services. The analysis is based on the latest available vehicle registration, statistical and market data. The publication is a joint project of the Polish Automotive Industry Association and KPMG Poland.

One click from insurance – Are the Poles ready for the digital channels?

This report was prepared on the basis of qualitative and quantitative research studies conducted on a representative sample of Polish digital consumers, in collaboration with Millward Brown. The qualitative research monitored the behaviour of digital consumers and their preferences recorded on an online platform over a one week period and sought to gain an in-depth understanding of the causes of the varied behaviour patterns, preferences and other phenomena through a series of six focus group interviews (FGIs). The quantitative study investigated prevalence of the observed behaviour patterns and preferences in the population of Polish digital consumers of 18 years and over.



The Luxury Goods Market in Poland. The 2015 Edition

The sixth edition of KPMG publication on the luxury goods market in Poland. The theme of this edition of the report were premium and luxury Polish brands. The report presents the results of a Computer Assisted Web Interview survey conducted in September 2015 on a group of 305 respondents using the method of online interviews. This analysis was completed with a study on premium and luxury brands owning companies.

Pulse of Economy

The report was prepared on the basis of a survey study conducted in September 2015 among 731 medium and large companies operating in nine countries of the CEE region: Poland, the Czech Republic, Slovakia, Hungary, Romania, Bosnia and Herzegovina and the Baltics. The survey questions covered the firms' standing as well as such general issues as investment attractiveness of Poland and other states of Central and Eastern Europe.

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