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Tax Alert

KPMG in Poland

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Ministry of Finance's explanatory notes regarding limitation of tax deductibility of certain intangible service fees and royalties

On 23rd April 2018 the Ministry of Finance ('MoF') published on its website explanatory notes concerning tax deductibility limitations of certain intangible service fees and royalties paid to related entities, as introduced into the Corporate Income Tax Act on 1st January 2018.

The explanatory notes issued by MoF have been divided into four sections. Key statements included in the said notes are presented below.

A. Tax deductibility limitation of certain intra-group service fees and royalty - general principles

According to the MoF, Art. 15e of the CIT Act should apply regardless of whether or not a given service/royalty agreement was executed prior to entry into force of the new provisions, as long as the tax costs related to such agreement are recognized by the taxpayer in the period, in which the new rules are in force, that is from 1st January 2018. An exception to this rule applies to taxpayers whose tax year commenced before 1st January 2018 and is different than a calendar year – these taxpayers are obliged to apply the new regulations as from their new tax year commencing after 1st January 2018.

According to the MoF's explanations, the correct application of Art. 15e of the CIT Act consists in:

1. Analysis of object and parties to the transaction (that is, who and for which services/IP rights must apply the limitation);
2. Determination whether a given service fee or royalty is excluded from the tax deductibility limitation (further to the Ministry's standpoint i.a. costs of services acquired from related entities and re-invoiced to other group entities, such as in the case of shared service centers, should be exempt from the restrictions);
3. Determination of amount of costs of services and rights falling within the limitation (reduced by applicable exemptions as mentioned above);
4. Computation of the amount of limitation applicable towards "qualifying" service fees and royalties (i.e. annually PLN 3 M + 5% EBITDA) – it has been underlined by the MoF that the restrictions must be applied during the tax year in terms of calculating the amount of monthly CIT advances;
5. Appropriate decrease of the tax deductible costs in the CIT computation.

B. Types of services covered by Art. 15e sec. 1 of the CIT Act

The MoF has also referred to specific types of services covered by the limitations.

With regard to consultancy services, further to the MoF exemplary services subject to deductibility restrictions are services classified under *PKWiU* 2015 (Polish Classification of Goods and Services) as consultancy services related to management (70.22.1) and services in the field of public relations and communication (70.21.10.0).

With regard to advertising services, the Ministry has indicated services classified under *PKWiU* 2015 as advertising services (73.1.) and referred to the CJEU judgments linking this type of services with diffusion of information, the purpose of which is to inform as many customers as possible about the existence and quality of goods or services and, as a result, to increase sales. It has been underlined that the above notion should not include services aimed at organization of promotional activities, such as loyalty programs or organization of parties, banquets, press conferences, congresses, seminars, contests, which may, depending on the circumstances, be considered as training or representation expenses.

As regards data processing services, the MoF has referred to services classified under *PKWiU* 2015 as data processing services (63.11.11.0) whereby stating that these services include processing and specialized reporting derived from data provided by the client or ensuring automatic data processing and data entry, including maintaining a database.

In relation to the notion of services of a similar nature to services explicitly listed under Art. 15e sec. 1 of CIT Act, the MoF has referred to the withholding tax case law, according to which such group includes both services with characteristics of the services explicitly mentioned in Art. 21 sec. 1 pt 2a of the CIT Act and services having as well characteristics of other (non-restricted) services, provided that the former prevail.

C. Types of services not covered by Art. 15e sec. 1 of the CIT Act

The MoF has clearly outlined that legal (including tax advisory), accounting, audit and employee recruitment services are not subject to restrictions under Art. 15e of the CIT Act.

In that regard, it is also worth noting the recent position of the tax authorities, according to which HR management services may be of consultancy character, hence be subject to the limitation under Art. 15e of the CIT Act.

D. Costs of services and use of rights directly related to the manufacturing or purchase of goods or provision of services

In the explanatory notes the MoF has pointed out that when examining the cost classification under the new restrictions one should take into account the link of the cost with the manufacturing or purchase of goods or provision of services, in particular whether the given costs are included in the costs of products, goods or services that affect their final price.

The cost of charging an entity for using the trademark in the distribution of products and conducting marketing and promotional activities of these products in Poland has been listed as an example of this kind of expenses (exempt from restrictions).

This means that, according to the MoF, it is not necessary to treat such expenses for CIT purposes as costs directly related to taxable profits.

In practice, however, the hitherto position of tax authorities has not been consistent in this regard. Therefore, the publication of the explanatory notes by the MoF might lead to establishing a more uniform approach by tax authorities in the months to come.

Consequences of publishing the explanatory notes

The explanatory notes published by the MoF, although not binding, constitute interpretative guidelines on which tax authorities should rely when assessing taxpayers' expenses incurred on services and use of intangible assets purchase from related entities in terms of the limitation resulting from Art. 15e of the CIT Act.

It should be noted that although the MoF's explanations are detailed, they do not address all doubts related to the application of the analyzed provisions. As a result, taxpayers should still seek to examine their individual tax position i.e. whether a given service fee or royalty is subject to the limitation under Art. 15e sec. 1 of the CIT Act.

Please contact us if you would like to obtain more detailed information on the above topic or analyze the impact of the Ministry's explanatory notes on the costs of services and use of intangible assets in your business.

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