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In this Issue

Introduction

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We have been running out of adjectives to describe the amendments to transfer pricing regulations. For many years, we have discussed something new almost every year. Many a time have we communicated that the new regulations are "significant" or "revolutionary" and that the amendments are "fundamental" or "thorough". It just shows how dynamic the development of the regulations concerning that issue is. At the same time, it is important that the future "revolutionary and significant" amendments will not become a challenge beyond our limits. At present, such a challenge is the reporting of transactions with related entities, which has been submitted in an electronic form (TPR) for the first time this year.

What is challenging is not only the correct TPR reporting and submission of the statement which does not expose members of the management board to personal liability but also such provision of information that it does not become the grounds for the institution of inspections. The preparation of TPR information may become a trigger for re-assessment of individual transactions or re-thinking of transfer pricing policy anew. It should be remembered that the information concerning transactions between related entities is provided to inspection authorities not only in the form of new TPR information but also through JPK, ORD-U, CBC reporting and even the financial statements themselves. Therefore, it is necessary to ensure the coherence and completeness of the data in all reports and documents filed with tax authorities.

The next year will not only be the year of a new reporting format. It is worthwhile to emphasise that the requirements concerning the elements of the transfer pricing documentation (i.e. the Local File, the Master File and benchmarking analysis) have been amended recently as well. Yet, in spite of clarifying the concepts and terms, such a basic issue like the identification of transactions continues to be troublesome for taxpayers. What does not change is the invariably high interest of the authorities in the transfer pricing policy as well as the growing number and intensity of inspections. Therefore, it is so important to be properly prepared for the discussion with tax authorities. The first source of information is – definitely – the transfer pricing documentation, but any evidence and documents related to the transactions, e.g. agreements, calculations, etc., are also of equal importance.

It should be remembered that during the talks with the authorities, all types of transformations and restructuring within capital groups are discussed increasingly often. The transfer pricing regulations provide for a number of guidelines on how to document and verify the restructuring process, as well as whether and when to charge the fee for the transfer of economically significant functions between the entities (the so-called exit fee). We are of the opinion that the restructuring issue will become the subject matter of particularly difficult tussles with tax authorities. Similar sensitivity is applicable to all transactions concerning intangible services or hard to value intangibles. This also relates to the analysis of the parties' contribution in the production, development and protection of intellectual property. The OECD Guidelines are useful and helpful, but we also need to remember about the domestic case law and the practices of tax authorities.

In this issue of the magazine, we also draw your attention to the growing importance of non-tax regulations. Even the planned amendments to the Code of Commercial Partnerships and Companies may contribute to the review of the assessment of transactions and business events occurring within capital groups.

All the aforementioned issues are discussed in our publication so that the "revolutionary and significant" tone of all amendments and challenges to be faced changes into the information which is easy to understand, and thus – easy to put into practice. We encourage you to read the articles and to contact us if you have any questions or doubts.

Wishing you a pleasant read!

Deadlines

Upon the entry into force of the Act dated 19 June 2020 on subsidies to interest rates of bank loans granted to enterprises affected by COVID-19 and amending certain other acts (the so-called "Anti-Crisis Shield 4.0"), the deadlines for transfer pricing reporting were extended. Under the Anti-Crisis Shield 4.0, the official deadlines for the submission of the following documents were prolonged until 31 December 2020:

- transfer pricing information (TPR-C and TPR-P forms), and
- statement on preparation of the Local File.

The above refers to cases when such deadlines is expiring between 31 March 2020 and 30 September 2020. If the said deadlines expire between 1 October 2020 and 31 January 2021, the taxpayers are granted three additional months for the fulfilment of their relevant reporting obligations. Furthermore, the Anti-Crisis Shield 4.0 also provides for the postponement of the deadline for preparing or attaching the Master File to the Local File until the end of the third month from the day following the day when the extended deadline expired for filing a statement confirming that a local transfer pricing documentation (the Local File) has been prepared. For taxpayers whose financial year ended on 31 December 2019, it means that:

- the deadline for preparing the Local File, filing TPR-C transfer pricing information returns and filing the statement on the preparation of the Local File expires on 31 December 2020; and
- the deadline for preparing or attaching the Master File to the Local File expires on 31 March 2021.

Statement on transfer pricing documentation since 2019 – is this only a formality?

The tax law regulations effective since 2019 introduce a broader scope of the statement on transfer pricing documentation. The statement on preparation of the Local File, apart from the confirmation that the Local File has been prepared, should include the statement of application of arm's length prices in related party transactions.

The statement on transfer pricing documentation is nothing new.

The obligation to file the statement on transfer pricing documentation was originally introduced in 2017. At that time, the taxpayers obliged to prepare the Local File submitted a statement on transfer pricing documentation in which they confirmed the fact of having the required tax documentation. The statement on transfer pricing documentation effective in the previous legal situation was limited to stating the fact of the timely preparation of tax documentation.

The regulations on transfer pricing effective since 2019 significantly expand the scope of the statement on transfer pricing documentation filed by taxpayers.

The regulations on transfer pricing effective since 2019 significantly expand the scope of the statement on transfer pricing documentation filed by taxpayers.

In the statements filed for 2019 and the following years, the taxpayers – in addition to confirmation of preparing the transfer pricing documentation for transactions subject to documentation obligation – will be additionally obliged to confirm that such transactions were effected pursuant to arm's length terms and conditions, that are the terms and conditions that would be agreed by and between independent entities.

Broader scope of the statement – greater liability?

In compliance with the regulations effective since 2019, the statement on transfer pricing documentation is filed with competent tax offices only by electronic means, with the deadline being the end of the 9th month after the end of the financial year.[1]

Pursuant to Article 11m of the CIT Act, the statement on transfer pricing documentation is signed by a manager of the undertaking, as interpreted in the Accounting Act, with specifying their function. When several people fulfil the criteria for a manager of the undertaking, or their designation is not possible, the statement is to be submitted and signed by each person authorised to represent a given undertaking. The regulations effective since 2019 do not provide for the possibility of filing the statement on transfer pricing documentation by an attorney.

The new scope of the statement obligates the persons obliged to submit it to verify not only the fact of having relevant transfer pricing documentation but also to check whether the terms and conditions of the transactions effected with related entities actually do not differ from arm's length terms and conditions.

From the perspective of taxpayers and managers of the undertaking, that is in the case of legal persons being the members of the management board of a company, the preparation of transfer pricing documentation and reliable benchmarking analyses results not only from the statutory obligation but is also the indication of exercising due diligence, which – in the case of potential tax audit – may protect the persons signing the statement against being held personally liable.

The amendment of the transfer pricing regulations under the PIT Act and the CIT Act also entailed the amendment to the provisions of the Fiscal Penal Code through adding Article 56c providing for the liability arising from the violation of the regulations concerning the submission of statements on transfer pricing documentation. Pursuant to Article 56c of the Fiscal Penal Code, the failure to file the statement on transfer pricing documentation, or the filing of the statement after the deadline, or the certifying of false information shall expose the liable persons to the threat of being imposed sanctions on personal grounds – in compliance with the cited provision, the listed actions constitute a prohibited act subject to the penalty that may be assessed up to 720 daily rates.

Free of charge transactions and the statement on transfer pricing documentation

The effective regulations stipulate the key issues related to the scope and the content of the statement on transfer pricing documentation. Nevertheless, the conclusion of certain transactions raises many doubts in practice in the context of the analysed statement and confirmation of the arm's length nature of effected transactions.

Recently, the taxpayers had doubts about the possibility of filing the statement on transfer pricing documentation including the confirmation of observing the arm's length prices in transactions in which the performance has been partially or entirely free of charge.

[1] Pursuant to Article 31z of the Anti-Crisis Shield 4.0., the deadline for filing the statement on transfer pricing documentation has been extended: (i) by 31 December 2020 – when the deadline expires between 31 March 2020 and 30 September 2020; (ii) by 3 months – when the deadline expires between 1 October 2020 and 31 January 2021.

The related entities which conclude controlled transactions may, in fact, encounter the situation in which – in compliance with the contractual provisions – they receive the performance for which their business partner does not expect any payment, the so–called free of charge performance. In compliance with the provisions of the CIT Act, it is recommended that the taxpayers recognise the revenue arising from the so–called free of charge performance and take it into account in their tax settlement. The absence of remuneration may arise from the adopted group policy in the scope of transfer pricing, reciprocity of performances, etc.

Furthermore, what is important is that the tax regulations applicable in the country of the registered office of a business partner with whom the taxpayer concludes the transactions may provide for the conclusion of the transactions in which the undertaking gives or receives the performance without remuneration. The OECD Guidelines allow the absence of the possibility of calculating the remuneration in the case of certain transactions if it is not contrary to the national regulations of the related entities concluding a given type of transaction.

Nevertheless, in the scope of filing the statements in the case of concluding free of charge transactions, the Head of the National Revenue Information issued two individual interpretations negative for taxpayers (0111-KDIB1-2.4010.495.2019.1.AW and No. 0111-KDIB1-1.4010.544.2019.1.BK dated 28 February 2020).

In both cited interpretations, the tax authority stated that the revenue from free of charge performances is not a transfer price determined on the basis of the terms and conditions that would be agreed by and between the independent entities. Therefore, and in spite of recognising the additional taxable revenue arising from free of charge performance by the taxpayer (that is – to give an example – giving of free of charge guarantee by a related entity), the taxpayer will not be entitled to file the statement on transfer pricing documentation.

While the Voivodeship Administrative Court in Wrocław, in the judgement dated 22 July 2020, files No. I SA/Wr 269/20, did not agree with the stance of the tax authority expressed in the interpretation No. 0111-KDIB1-1.4010.544.2019.1.BK, and thus overruled the individual interpretation appealed against by the taxpayer.

In the statement of reasons given orally, the Voivodeship Administrative Court emphasised the essence of the objective of the introduced regulations. In the case of receiving the free of charge performance and recognising the taxable revenue arising therefrom, the taxpayer undertakes to pay the tax on that account, and thus increases the revenues to the state budget (incurs additional costs paid to the state which the taxpayer would not have incurred in the case of free of charge performance). Thus, the taxpayer should not suffer the negative consequences of the activities which are not aimed at tax avoidance or profit transfer. The Voivodeship Administrative Court emphasised that in the analysed case, it was not possible to approve the stance of the tax authority that had rejected the possibility of filing the statement by the authorised persons, and also indicated that such a statement would refer to a transaction which was not concluded in market realities because that case dealt with the free of charge performance (the giving of free of charge guarantee for a credit by the majority shareholder).

* * *

We hope that the cited decision of the Voivodeship Administrative Court will permanently change the existing interpretation trends which were unfavourable particularly for the taxpayers who conclude the transactions consisting in the receipt of free of charge performances and recognise the additional revenue arising therefrom, given the lack of possibility of filing the statement, which would result in the personal fiscal penal liability for the managers of the undertakings of such taxpayers.

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What's new in the *Local File* and the *Master File*?

Since 1 January 2019, certain elements of the Local File and the Master File have been amended, and the criteria for the identification of documentation have also been changed in a significant manner. At present, it is no longer important what revenues or costs were generated for the preceding year in order to determine documentation obligations, as was the case in 2017–2018.

Based on the regulations currently in force, the documentation obligation arises depending on the net value of the homogenous controlled transaction which exceeds the following thresholds in the financial year:

- PLN 10 million – for commodity and financial transactions,
- PLN 2 million – for service transactions and other transactions,
- PLN 100 thousand – for transactions consisting in the payment of amounts due to entities having their registered office in the so-called tax havens (it also refers to the deeds of a company/partnership which does not have a legal personality and joint venture agreements, etc.)

The documentation thresholds are determined separately for each homogeneous controlled transaction, regardless of the assignment of the controlled transactions to commodity, financial, service or other transactions, and separately for the cost- and revenue-generating part of a given taxpayer.

Furthermore, it should be noted that since 2019 the transfer pricing analysis (the benchmarking analysis or the so-called compliance analysis) has been an obligatory element of the Local File. The only exception from that rule includes the transactions to which taxpayers apply the so-called simplified settlement rules (*safe harbours*).

The most important changes in the transfer pricing documentation effective since 2019

Local File

It should be emphasised that in 2019 there were no radical amendments made to the obligatory elements of the Local File. In relation to the part of the documentation dealing with the related entity, certain new elements were introduced. They concern but are not limited to the following:

- the identification of geographical markets where the related entity performs business activities;
- the description of the industry and market environment, with the identification of the influence of economic and regulatory circumstances, and with the description of key competitors, and
- the information about economically significant functions, assets or risks influencing the related entity which have been transferred by and between the related entities in the financial year and in the year preceding the documented financial year if such transfer occurred.

Furthermore, since 2019, it has been necessary to explain the assumptions made within the description of the manner of transfer pricing calculation. The obligation to present the added value chain and functional profile of the parties to the documented transactions was withdrawn in 2019 in relation to the *Local File*.

Transfer pricing analysis

An important change in the transfer pricing analysis effective since 2019 includes the identification of the method applied to verify the prices together with the concise justification of the selection of a given method with the justification of the selection of search criteria. In addition, the comparable data has to be presented in an electronic form allowing its editing, grouping, sorting and performing the verification of the calculations made. Furthermore, since 2019, the comparable data rejected under the transfer pricing analysis have been an obligatory element of the benchmarking analysis. Another equally important change concerning the transfer pricing analysis is the identification of the elements of the so-called compliance analysis in the case when the preparation of the benchmarking analysis is not possible or adequate in view of the transfer pricing verification methods provided for in the regulations. In addition, it is also required – within the transfer pricing analysis – to view the transfer price in terms of the result of the analyses, together with the explanation of possible deviations.

Master File

The most important changes in the scope of the Master File apply to the new way of defining the obligation to prepare the Master File. The obligation to prepare it occurs if the following three conditions are fulfilled cumulatively:

- the entity is obliged to prepare the Local File,
- it belongs to the group of related entities for which consolidated financial statements are drawn up,
- the consolidated revenues of the group of related entities exceed PLN 200 million in the preceding financial year.

The new requirement provides for the inclusion of the information concerning the added value chain for five groups of products or services which are the most significant in terms of revenues and such groups of products or services which generate the revenues exceeding 5% of the consolidated revenues of the capital group, together with the identification of the main geographical markets for such groups of products or services. Furthermore, the new formal requirements for the Master File provide for the inclusion of the concise description – with words – of the functional analysis presenting the significant share of the related entities in the creation of the value within the capital group; the attachment of the consolidated statements of the group and the inclusion of the list and concise description of the unilateral advance pricing agreements concluded by the entities from the group or other tax binding rulings concerning the assignment of the income between the countries. The Master File may be drawn up by any entity belonging to the Group. Yet, the Master File submitted in Poland has to be compliant with the Polish regulations. When the Master File has been drawn up in the English language, the tax authority may demand that the Master File be submitted in the Polish language (within 30 days of being served such a demand).

> The new transfer pricing documentation regulations, effective since the beginning of 2019, have significantly changed the existing approach in many aspects, including in relation to the determination of the documentation obligations imposed on the related entities or the inclusion of the transfer pricing analysis to the *Local File* every single time.

Important deadlines

Upon the entry into force of the Act dated 19 June 2020 on subsidies to interest rates of bank loans granted to enterprises affected by COVID-19 and amending certain other acts (the so-called "Anti-Crisis Shield 4.0"), the deadlines for transfer pricing reporting were extended. Under the Anti-Crisis Shield 4.0, the official deadlines for the submission of the following documents were prolonged until 31 December 2020:

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Summary

The new transfer pricing documentation regulations, effective since the beginning of 2019, have significantly changed the existing approach in many aspects, including in relation to the determination of the documentation obligations imposed on the related entities or the inclusion of the transfer pricing analysis to the Local File every single time. At present, the main purpose of the transfer pricing documentation is to evidence that a controlled transaction is the arm's length one, and not taking into account all formal elements of the documentation. In spite of the relatively small number of formal changes introduced to the scope of the Local File and the Master File and the prolonged deadlines for reporting, the taxpayers should commence the diligent fulfilment of the documentation obligations for the year 2019 as soon as possible, especially given the connection of the information included in the Local File with the new reporting of transfer pricing information (TPR-C and TPR-P form).

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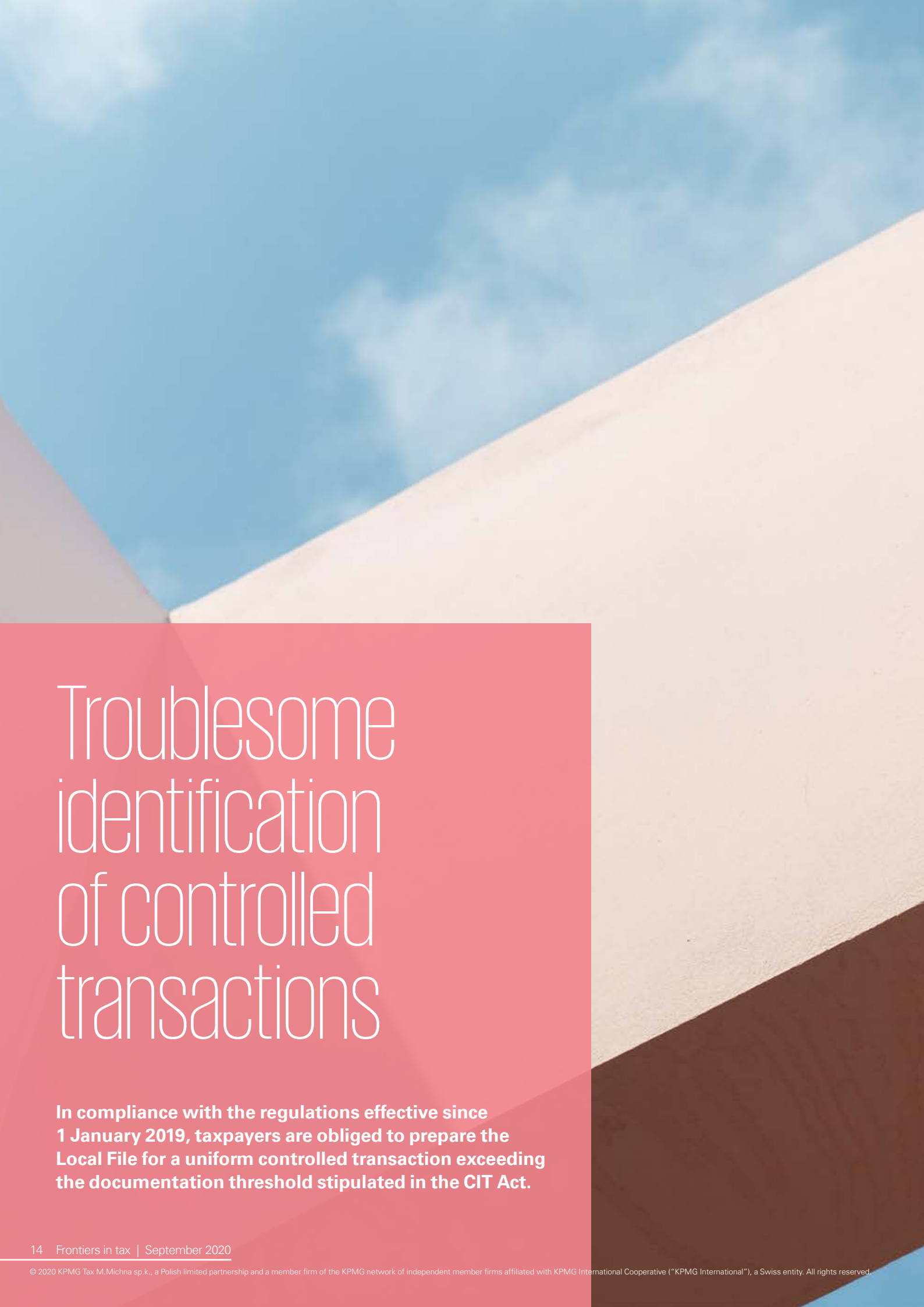

Troublesome identification of controlled transactions

In compliance with the regulations effective since 1 January 2019, taxpayers are obliged to prepare the Local File for a uniform controlled transaction exceeding the documentation threshold stipulated in the CIT Act.

While the concept of uniformity of a transaction as interpreted in the Polish tax regulations seems not to raise significant doubts and should be viewed in compliance with the literal wording of the provisions of the CIT Act, the taxpayer – given the broad definition of a controlled transaction – may have reservations relating to the scope of the necessity of drawing up the transfer pricing documentation for individual categories of transactions concluded with related entities.

Definition of a controlled transaction

According to the statutory definition, a controlled transaction means business activities identified based on the actual behaviour of the parties, also including the allocation of the income of a foreign establishment, terms and conditions of which are agreed or imposed on the grounds of the existence of relations.

Thus, the concept of a controlled transaction includes any and all activities undertaken by taxpayers with related entities of a diverse nature and objectives. In the justification to the amended regulations, the legislator stated that the introduction of such a broad definition is aimed at applying the documentation obligation not only to routine basic transactions concluded by and between the related entities (such as service, commodity or financial transactions) but also other events which may not constitute a transaction in the common meaning of the word, but which terms and conditions are agreed by and between the related entities. Among other things, it is about any restructuring processes, partnership deeds, cooperation agreements, or cost sharing agreements.

When analysing the documentation obligations, a taxpayer should view the business activities undertaken with the related entities and analyse them in the context of the documentation obligations in the broadest possible scope.

TPR-C information as a tool supporting the identification of controlled transactions

In order to identify and confirm the list of identified transactions covered by the documentation obligation, it is advisable to refer to a TPR-C form which is used by a taxpayer to provide the tax authorities with detailed information about the controlled transactions concluded in a given fiscal year. Generally, each documented transaction should be subject to reporting under TPR-C form, and therefore the list of controlled transactions available in the form may be a kind of a crib for taxpayers.

Equity transactions and documentation obligation

In spite of the foregoing, the effective tax regulations as well as the TPR-C form itself are the source of differences and doubts as to the documentation obligation in relation to selected events. One of such examples is a transaction concerning the increase of the capital by a shareholder in a company.

In compliance with the judgement issued by the Supreme Administrative Court in the preceding legal state, records No. II FSK 2597/18 dated 20 February 2019, the event consisting in the increase of the capital in exchange for cash contribution was not subject – pursuant to the former regulations – to documentation obligation. Furthermore, as stated in the draft explanations to TPR-C form dated May 2020 (which, however, should not be treated as an interpretation of the law), the obligation to document the increase of the capital does not exist, while a broader restructuring event may be covered by it with the increase of the capital being only one of the elements. Also, the purpose of the prepared documentation, that is the justification of the arm's length nature of a price applied in the transaction, may indicate that the documentation of such an event – which is by definition applicable to related entities, and thus causing the practical problem of specifying the arm's length nature of the agreed price – may not be justified. Whereas, any doubts in the aforementioned scope are multiplied by the interpretations that have been issued recently, in particular the one with records No. 0111-KDIB1-2.4010.166.2020.2.AK dated 17 August 2020 stating that additional payments to the capital of a company by its shareholders should be documented. What's important, the materiality threshold in the aforementioned case was determined at the level of PLN 10,000,000, that is similarly to a financial transaction to which such a type of event was compared. However, it is possible that the line in this scope may be changed and, therefore, it is advisable to monitor the interpretations and judgements issued under the regulations effective since 2019.

> When analysing the documentation obligations, a taxpayer should view the business activities undertaken with the related entities and analyse them in the context of the documentation obligations in the broadest possible scope.

At the same time, in compliance with the response to the parliamentary question with records No. DCT2.054.1.2020 dated 22 August 2020, the payment of dividends does not meet the definition of a controlled transaction which would be subject to the documentation obligation.

Financial transactions and transaction values

When specifying the documentation obligations, a taxpayer should pay special attention to financial transactions concluded with related entities. This is because the determination of the value of a transaction, and – in consequence – the determination whether a given transaction is subject to the documentation obligation – is not always simple and transparent.

One of such examples may be the situation of granting the financing between the related entities for which the value of the principal amount – pursuant to the agreement concluded in the previous years – exceeds the statutory threshold of PLN 10,000,000, while the amount which is actually made available in the period is lower than that. In such a situation, it should be stated that in compliance with Article 11l (2) (2) of the CIT Act, the value of a controlled transaction in the case of financial transactions is defined based on agreements or other documents. In consequence, regardless of the actual degree of disbursement of – for instance - a loan, if the amount arising from the concluded agreement exceeds the threshold, the party to the agreement will be obliged to draw up the transfer pricing documentation for such a transaction in each year of the term of the agreement.

Another doubt may be raised in the scope of the correct determination of the value of cash pooling transactions which should be related to the threshold. The explanations to TPR-C may be useful. In compliance with their draft version dated May 2020, when determining the amount of a controlled transaction for cash pooling agreements, a principle adopted for the determination of the transaction value should be similar to the one applicable to a loan. Nevertheless,

given the specific nature of cash pooling transactions, the value of the principal amount does not always arise from the concluded agreement. In such a case, the transaction value should be determined based on other documents (including summaries of balances), taking into account the balance of the principal amount that the entity received or made available under the controlled transaction in a given financial year.

Regardless of the aforementioned, both the provisions of the CIT Act and the explanations do not clearly specify which balance – the average, the highest or one defined using other means – should be taken into account when determining the transaction value.

Free of charge financial transactions

It should also be remembered that in line with the literal wording of the regulations as well as the current case law, the receipt by a taxpayer of a gratuitous financial contribution (e.g. in the form of guarantee or surety) from the related entity constitutes a transaction as interpreted in the CIT Act which – provided that materiality criteria are met – will be subject to the obligation to draw up the tax documentation in spite of the absence of the agreed remuneration.

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In addition to the events which directly arise from the provisions of the CIT Act and are the continuation of the practice in the scope of identifying documentation obligations from the previous years, the amended regulations also provide for other new events which may be troublesome for taxpayers in the scope of their assessment in terms of the obligation to draw up the transfer pricing documentation. Therefore, it should be stated that in the context of amended transfer pricing regulations, the taxpayers should pay special attention to the correct and detailed identification of business events effected with the related entities.

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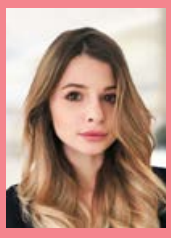

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Transfer pricing reporting – a new phase

Apart from the introduction of important amendments relating to the identification of transactions subject to documentation and improvement in the scope of the arrangement of transfer pricing documentation, the amendment to pricing transfer regulations, which became effective on 1 January 2019, has also changed the existing reporting of related party transactions. CIT-TP and PIT-TP forms have been replaced with TPR-C and TPR-P returns.

The new forms require the provision of a much greater amount of information concerning the taxpayer, including – to give an example – the financial information of a given entity in the form of selected financial ratios, as well as other detailed information concerning the transactions concluded with related entities.

> Transfer pricing information (TPR-C/TPR-P) should be submitted by means of electronic communication with the use of the form made available in the Bulletin of Public Information.

Who is obliged to prepare TPR-C/ TPR-P returns?

Transfer pricing reporting under the new obligation is obligatory for entities which conclude controlled related party transactions fulfilling the criteria for their inclusion in transfer pricing documentation, as well as (in a limited scope) entities qualifying for the so-called domestic exemption under which they are not obliged to prepare transfer pricing documentation.

Such an exemption from the documentation obligation referred to hereinabove is applicable in the case of conclusion of transactions by and between domestic entities if none of such entities suffered a tax loss in the year subject to the documentation, enjoyed the exemptions related with the business activity in special economic zones and/or other tax exemptions.

What is important, the TPR-C/ TPR-P return may also be prepared for the transactions concluded with independent entities in the scope in which a Polish taxpayer makes the payment of the amount due or concludes a deed of a company/ partnership not being a legal person (after exceeding specified limits) for the benefit of an entity carrying out the business activity in a country applying harmful tax competition.

Information provided under TPR-C/ TPR-P returns

As stated hereinabove, the information provided under TPR-C and TPR-P returns is definitely more detailed than the information required under CIT-TP/ PIT-TP.

The most important elements include, first of all, information concerning the related entities, information about the transfer pricing methods of determining and verifying the prices, and – what is more important – the profit level indicators applied in each benchmarking analysis prepared for a documented transaction. Taxpayers are obliged to indicate the results of benchmarking analyses , both in the scope of full ranges of results and interquartile ranges.

Such detailed data enable the tax authorities not only to assess the financial results generated by individual taxpayers but also to verify the profitability of individual transactions concluded with related entities. In consequence, it will be possible to select for control – in a precise way – not only the taxpayers(as was the case of CIT-TP/PIT-TP returns) but individual transactions, without the necessity of commencing any verifying activities.

Deadlines and manner of submission of TPR-C/TPR-P transfer pricing information

Pursuant to the CIT Act and the PIT Act, the TPR-C and TPR-P forms are submitted in an electronic form to the Head of the National Revenue Administration by the end of the ninth month after the end of the tax year.

However, the year 2020 (during which the transactions concluded by taxpayers in the tax year beginning after 31 December 2018 are reported) will be a specific year as – because of the COVID-19 pandemic – the deadline for TPR-C/TPR-P reporting has been prolonged until 31 December 2020 (if the deadline for the submission of transfer pricing information is expiring between 31 March 2020 and 30 September 2020) or by three months (if the said deadline expires between 1 October 2020 and 31 January 2021).

Transfer pricing information (TPR-C/ TPR-P) should be submitted by means of electronic communication with the use of the form made available in the Bulletin of Public Information.

What is the future of the TPR-C/TPR-P return?

The new reporting will surely provide taxpayers with numerous problems related with the selection of the relevant data for inclusion in the return and the collection of relevant information from the group. Nevertheless, Poland is not isolated in the implementation of the reporting, which imposes full transparency in the scope of the transactions concluded with related entities. It is very important how such type of reference data will be analysed and what

conclusions will be drawn because the occurrence of the indicators/ ratios exceeding certain limits in some situations may have a full economic and business justification.

It could be said that in 2020 there should be no fundamental changes in the formula of TPR-C/TPR-P, whereas it may be expected that the scope of the data provided under transfer pricing reporting will be expanded in the coming years.

In the future, the data obtained from the TPR-C/TPR-P form may be used in the automatic analysis to search the deviations from – to give an example – the typical results, which will enable the authorities to select taxpayers and transactions for inspection in an even more efficient way.

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Sources of information about intra-group transactions and amendments to the CCP&C

The progressing digitalisation of tax administration enables faster and more automated fulfilment of tax obligations on the one hand, and on the other constitutes a vast source of data for tax authorities about the transactions concluded by taxpayers with related entities. The information about intra-group transactions is not only provided by the TPR form but also by JPK, ORD-U, CbC forms and financial statements.

Standard Audit File (JPK from Polish *Jednolity Plik Kontrolny*)

From 1 October 2020, all VAT payers are to be obliged to submit – monthly – the new JPK_VAT file in the form of an electronic document comprising two parts – the registration part (including the VAT records of purchases and sales) and the declaration part. The new JPK file will require taxpayers to apply special designations not only in relation to the subject matter of the sale but also in relation to transaction types. An applicable symbol in the case of transactions with related entities will be TP.

It should be noted that the information transferred in the JPK_VAT form will make it easier for tax authorities to verify the arm's length nature of the prices applied in transactions between related entities, e.g. through the application of the comparable uncontrolled price method in the variant of internal comparison, by compiling the selling prices for comparable commodities in transactions with related and unrelated entities.

ORD-U form

ORD-U forms enable legal persons, organisational units without legal personality and natural persons running business activity to fulfil their obligations in the scope of providing tax authorities with the data about agreements concluded with non-residents as interpreted in the provisions of the foreign exchange law, including the identification data of the obliged party and the non-resident.

The obligation to file ORD-U forms is imposed on the aforementioned entities if the conditions provided for in the Regulation dated 24 December 2002 on tax information have been fulfilled and the following defined thresholds have been exceeded: EUR 300,000 in the case of agreements between related entities, or EUR 5,000 for agreements with non-residents having an enterprise, branch or representative office (as interpreted in separate regulations) in the territory of the Republic of Poland.

It should be noted that the threshold of equity ties pursuant to the regulations concerning ORD-U is 5% and therefore it is more restrictive than the threshold of equity ties stipulated in transfer pricing regulations which is equal to 25%.

ORD-U forms should be filed within three months of the end of the financial year. The information is to be filed regardless of the tax authority sending a request.

What is important, on 1 January 2019, the regulation concerning the exemption from the obligation to submit information about agreements concluded with non-residents in the ORD-U form applicable to the taxpayers who filed simplified CIT-TP / PIT-TP statement for the financial year 2018 was repealed and thus the fact of filing the TPR form for the financial year 2019 does not exempt from the obligation to submit the ORD-U tax return.

CbC form

The next source of information about transfer pricing is the CbC-R form (*Country-by-Country Reporting*). The obligation to file the CbC-R form is applicable to all parent undertakings belonging to the group of entities having their registered office or management in the territory of the Republic of Poland, with consolidated revenues equal to PLN 3.25 billion ifthe financial statements are drawn up in Polish zlotys, or to EUR 750 million or the equivalent amount.

The information provided in the CbC-R form includes mainly the size of the conducted business activities (the amount of assets, initial capital, number of employees), the size of generated revenues (broken down into those generated from independent entities and the undertakings belonging to the groups of entities), the generated profits (or losses), paid (and due) tax, locations of conducting business activities and the objects of such business activities.

The information about the group of entities may be used by tax authorities to analyse the risk of understating the taxable income in the area of transfer pricing and for other economic or statistical analyses.

In addition, the entities being members of capital groups with their results consolidated in the financial statements of the group subject to the obligation of CbC-R reporting and not being the parent undertaking are obliged to submit the CbC-P notification specifying the reporting entity and the country in which the relevant CbC-R report will be submitted.

The deadline for submitting the CbC-R information about the group of entities expires upon the end of the 12 months after the day ending the reporting financial year, while the deadline for submitting CbC-P notification is three months after the day ending the reporting financial year of a given group of entities. The information is to be filed electronically, regardless of the tax authority sending a request.

Financial statements

Also, financial statements may provide tax authorities with transfer pricing information. The Accounting Act imposes the obligation of revealing transactions with related entities in financial statements. Thus, tax authorities may look for additional information both in the profit and loss account, balance sheet, cash flows statement and relevant notes to the financial statements.

> The information about the group of entities may be used by tax authorities to analyse the risk of understating the taxable income in the area of transfer pricing and for other economic or statistical analyses.

Amendments to the Code of Commercial Partnerships and Companies

The Code of Commercial Partnerships and Companies (CCP&C) was created in 2000 and since that time, it has not been updated and reformed in multiple areas.

The amendment to the CCP&C is planned for the fourth quarter of 2020. The amendments will include new regulations concerning the introduction of the so-called holding law (the law of the groups of companies, concern law). The participation in the group of companies by the parent company and a subsidiary is to be revealed in the National Court Register through the entry of the relevant note into the register. The proposed amendments are to provide the parent company with the possibility of giving other companies from the group binding instructions in order to pursue a joint strategy, provided that the subsidiary – upon the satisfaction of appropriate conditions – may refuse to carry out the binding instruction, for example, if compliance with the instruction could lead to the insolvency of the said company or to the threat of insolvency, or there is a justified threat that it is contrary to the interest of the said company and will cause it harm which will not be repaired by the parent company or another subsidiary belonging to a given group in the period of the next two years.

In addition, under the amendments to the CCP&C, the subsidiary belonging to the group of companies is obliged to draw up a statement on the ties of the said company with the parent company for the period of the last financial year and to specify the binding instructions given to that company by the parent company. Such a statement is to be a part of the management report.

Furthermore, the holding law is to regulate the private law relations between the parent company and its subsidiaries in a manner that takes into account the interest of creditors, members of corporate bodies and minor shareholders of – especially – the subsidiary. The amendment to the CCP&C also introduces the business judgement rule to the Polish legislation, which consist in the exclusion of the liability of the managing persons for harmful consequences of their decisions provided that certain standards of conduct in the scope of diligence and loyalty to the company when making specific business decisions are fulfilled, and the said amendment also defines the basic obligations of the members of corporate bodies.

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Given such amount of information and data provided in different forms to tax authorities, the taxpayers should not only pay attention to the coherence of the provided data but also perform the transfer pricing audit in order to identify issues which may be of interest to tax authorities and may possibly lead to the selection of a given taxpayer for inspection. The exercising of due care in the fulfilment of any and all obligations related to reporting may be advantageous given the amended regulations of the CCP&C.

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Restructuring – definition and methods of its documentation

The reallocation of functions and resources between entities is an inherent element of operations of international capital groups striving to optimise their business activities. Any reorganisation activities undertaken between related entities which may constitute restructuring as interpreted in transfer pricing regulations should be, however, appropriately studied and documented.

Broad definition of restructuring

The regulations effective since 2019 have introduced a broad definition of restructuring which assumes the joint fulfilment of two conditions. It should be emphasised that the legislator has not provided for exclusions for reorganisations under the same tax jurisdiction, and therefore the transfers made between domestic related entities will also be subject to assessment in terms of the regulations in question.

The first condition for considering a given reorganisation as the restructuring is that it has to include a significant change of trade or financial relations, including the termination of effective agreements or the amendment to their significant terms and conditions. Yet, the legislator has not specified a catalogue of events (closed or even including examples only) which may be considered as the restructuring as interpreted in transfer pricing regulations. However, making use of the recommendations of the Transfer Pricing Forum, that is an advising body operating at the Ministry of Finance, the examples of the events which may constitute the restructuring should include the sale of an organised part of the enterprise, the change of the functional model of distributor or manufacturer, as well as – what is particularly important in the context of the current pandemic – the transfer of a team or a part of the employees between the entities, or limitation or expansion of the scope of the regional operations of one entity at another related entity's expense. The corrections to the TP policy or settlements methods will not be considered to be the restructuring if they are not associated with the transfer of functions, assets or risks (yet, such changes will be analysed pursuant to the general principles arising from Article 11c of the CIT Act).

The second condition for considering a given reorganisation as the restructuring stipulates that it has to be connected with the transfer of functions, assets or risks between the related entities if the expected average annual EBIT of the taxpayer in the three-year period after performing the reorganisation differs by at least 20% from the financial result that would be generated in the situation if such transfer had not been effected. The analysis of the change of the average annual EBIT should be performed upon the performance of the restructuring, that is based on the financial data prepared in advance (*ex ante* analysis). The regulations do not impose the obligation to verify the compliance of the applied financial forecasts with the actual data (*ex post* analysis) – with the exclusion of the situation when the valuation includes hard to value intangibles. The ex post assessment may, however, include the reliability and accuracy of the prepared forecasts of financial data and the assumptions made for them, which may be of particular importance in the context of the current pandemic. Thus, any and all financial forecasts prepared in connection with the restructuring should be duly documented in a manner allowing their verification and recalculation in the later period.

Objective of restructuring regulations

For the tax authorities, the restructuring regulations constitute a tool allowing for the efficient verification of the terms and conditions of reorganisation, including the justification for and the amount of the remuneration paid by and between the related entities in the transactions involving, in particular, the transfer of the potential to generate profit. To give an example, when examining the transaction of sale of fixed assets (e.g. of production machines), an authority may state that the transaction has been in practice accompanied with the transfer of rights under commercial contracts. In consequence, the taxpayer who has made such a transfer will have the income adjusted upwards at the amount of the additional remuneration for the transferred profit potential, the so-called exit fee.

Ways of documenting the restructuring

It cannot be forgotten that the taxpayers participating in the restructuring processes are expected to fulfil a number of new documentation and reporting obligations which are as follows:

1. Transfer pricing documentation

The restructuring should be appropriately recognised in the Local File. The events constituting the restructuring are presented in the part constituting the description of the basic activity of the related entity (the so-called general part), within the information about the transfers of economically significant functions, assets or risks. In addition, when the value of the transactions constituting the restructuring exceeds the documentation thresholds, the Local File is prepared for them in the part constituting the description of the transaction, including the functional analysis, in compliance with §2 of the Regulation on the transfer pricing documentation.

2. Restructuring documentation

However, the currently effective regulations for the events meeting the definition of the restructuring provide for the additional requirements exceeding the elements of the standard Local File and regulated in Chapter 4 of the Regulation on transfer pricing. This relates to the earlier regulations which directly referred to the requirements of preparing separate restructuring documentation. Since 2019, the comparability study in the case of the restructuring also includes, among others:

- the identification of commercial or financial relations between the related entities before and after the restructuring, including the identification of actual transactions constituting the restructuring, the analysis of business reasons for the restructuring and the expected benefits, and the analysis of viable options. The information in that scope enables the determination of the changes in the functional analysis caused by the restructuring, and in consequence, the determination of the scope of the transfers effected;
- the determination of the tax consequences of actual transactions constituting the restructuring (of which, to give an example, the consequences of the tax recognition of the restructuring fee);
- the determination of the scope of transfer of the potential to generate profit as a result of the restructuring,

> An important stage of the restructuring process is the preparation of the business justification for the implemented changes.

- the specification whether the remuneration relative to the restructuring is due, if yes – the assessment whether its amount is justified. It should be remembered that in a given case, the remuneration may not be justified or could have been already taken into account, e.g. in the price for the transferred organised part of the enterprise.

3. TPR form

The events constituting the restructuring (provided that they exceed the documentation thresholds) should also be shown in the transfer pricing information filed with the use of the TPR form, and the manner of showing the transaction should be consistent with its description presented in the documentation. It should also be remembered that when making the choice of the relevant category of a transaction in the form, the taxpayer specifies at the same time whether any remuneration has been agreed in the restructuring.

4. Analysis of the performed valuation

Since 2019, the valuation techniques have been directly recognised under the provisions of tax acts as one of the transfer pricing verification methods. Yet, this method can be applied only in the case when it is not possible to apply any of the basic methods (that are the comparable uncontrolled price method, resale price method, cost-plus method, transactional net margin method, profit split method). Furthermore, the exact way of applying the valuation technique is outlined in § 15 of the Regulation on transfer pricing.

In consequence, each valuation performed for the purposes of the restructuring (and not only) should undergo an additional analysis in terms of transfer pricing. It should be emphasised that such an analysis has two objectives:

- The first of them is to confirm the correctness of the choice of the valuation method in terms of transfer pricing, that is to justify that the valuation is the method which is the most applicable in given circumstances and that none of the basic methods could be applied or their application would not be adequate in given circumstances.

- The second objective is to confirm the manner of performing the valuation in terms of transfer pricing (§ 15 of the Regulation on transfer pricing), that is to assess it in terms of applied financial forecasts, quantities or indicators applied in the calculation of the value of the subject matter of a controlled transaction, the selection of the discounting factor (if applicable) or the level of value of the controlled transaction expected by each of the parties to the transaction.

5. Business justification for the restructuring

An important stage of the restructuring process is the preparation of the business justification for the implemented changes. As mentioned hereinabove, in terms of transfer pricing, such a justification which includes, among others, the analysis of economic reasons for the restructuring and the expected benefits, as well as the analysis of viable options, is an element of the restructuring documentation.

In the case of a merger or division of the companies/partnerships, the obligation to prepare a written report justifying the restructuring, its legal and economic grounds, and in particular the ratio of exchange of shares, results directly from the provisions of the Code of Commercial Partnerships and Companies. It should also be remembered that the preparation of the reliable business justification, including economic analyses and profitability reports, constitutes the necessary requirement of the tax neutrality of the restructuring. In the case of a merger or division of the companies/partnerships, the possibility of applying the exclusions from the taxable revenues provided for in Article 12 (4) (3e), (3f) and (12) of the CIT Act has been made conditional upon the fact whether the restructuring was performed for justified economic reasons. In the case of their absence, it is presumed that the main purpose or one of the main purposes of the restructuring was to avoid or evade taxation.

6. MDR

The restructuring may also constitute a tax scheme subject to MDR. Special attention should be paid to the following two specific hallmarks of the arrangement:

- The transfer of rights to hard to value intangibles;

- The transfer of functions, risks or assets between the related entities if the expected annual financial result before interest and taxes (EBIT) in the three-year period after such transfer was equal to less than 50% of the expected annual EBIT that would be generated in the situation if the transfer had not been made.

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Given the regulations under analysis, we recommend that taxpayers pay special attention to intra-group restructuring processes, prepare suitable documentation when a given event fulfils the restructuring criteria, including business justification, and perform the relevant restructuring reporting.

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Intangible, yet substantial – what's good to know about intangibles?

The amendments made to the transfer pricing regulations at the beginning of 2019 seemingly have not substantially influenced the issues connected with the determination of prices in transactions involving intangibles. Yet, a detailed analysis of the regulations and tax authorities' activities makes it worthwhile to take a closer look at this category of transactions.

What are intangibles?

It should be noted at the outset that the Polish transfer pricing regulations do not define the concept of intangibles but only the concept of intangible assets subject to amortisation. In order to determine the meaning of the term "intangibles", it is good to refer to the OECD Guidelines which define it as the property right which is not a physical asset or a financial asset, and which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Thus, the concept of intangibles should be viewed in the context of transfer pricing quite extensively, and the analysis of regulations requires that special attention be paid each time to whether the legislator used the term "intangible assets" or a broader term "intangibles".

Intangibles pursuant to new regulations

Pursuant to the transfer pricing regulations effective since 2019, the controlled transactions with their subject matter being intangible assets are treated in a special way. The related entities are obliged to prepare the Local File for each transaction from that category with the value exceeding the statutory threshold equal in this case to PLN 2,000,000.00, even if the value of the controlled transaction does not constitute – permanently and in its entirety – the revenue or tax deductible cost for the taxpayer. In spite of the fact that the amendment to the CIT Act introduced a new catalogue of exemptions from the obligation to prepare the Local File, and that one of the grounds for such exemption is the conclusion of a controlled transaction with its value not influencing the revenues or tax deductible cots for the taxpayer, the regulation excludes the possibility of using the exemption for the transactions which refer – among others – to intangible assets.

The issues connected with intangibles should also be taken into account in the Master File, which has to include the description of significant intangible assets of the group of related entities. Thus, the entity drawing up the Master File has to ensure that the documentation includes, among others, the list of intangible assets or their groups significant in terms of transfer pricing or the description of the transfer pricing policy in the scope of intangible assets.

The issue of intangibles also deserves greater attention in the scope of the obligation to submit the transfer pricing information ("TPR"). The Regulations of the Minister of Finance on transfer pricing information provide for the additional elements which should be shown in the TPR in the case of transactions connected with intangibles. If the subject matter of a controlled transaction is to make intangibles available or to use them, then the TPR should additionally state, among others, the type of the intangible and the manner of calculation of a fee for making it available or for using it. Therefore, when filling in the TPR information, the taxpayers have to be aware of the necessity of including more detailed information in relation to this category of transaction.

It should also be remembered that using the intangibles for a fee under the transactions with related entities may be subject to – based on the CIT Act – the limitation of the tax deductible costs in such a part in which the costs incurred in connection with such use exceed the statutory limit. In such a case, the taxpayers may consider the submission of the request that an individual interpretation of the tax law regulations be issued or the request that an advance pricing arrangement (APA) be concluded. Such an individual interpretation gives the possibility of applying the exemption provided for in Article 15e (11) of the CIT Act. If a positive interpretation is issued, it is possible for the taxpayer to have the costs which are directly connected with the production or acquisition of the goods or provision of services by the said taxpayer excluded from the limitation rule. In the case of APAs, the aforementioned limitation is not applicable to the transaction covered by the concluded arrangement.

Tax authorities' approach to intangibles

The interest of tax authorities in the issue of transfer pricing continues to grow, while the transactions concerning intangibles are increasingly often subject to assessment during tax proceedings and inspections or customs-tax inspections.

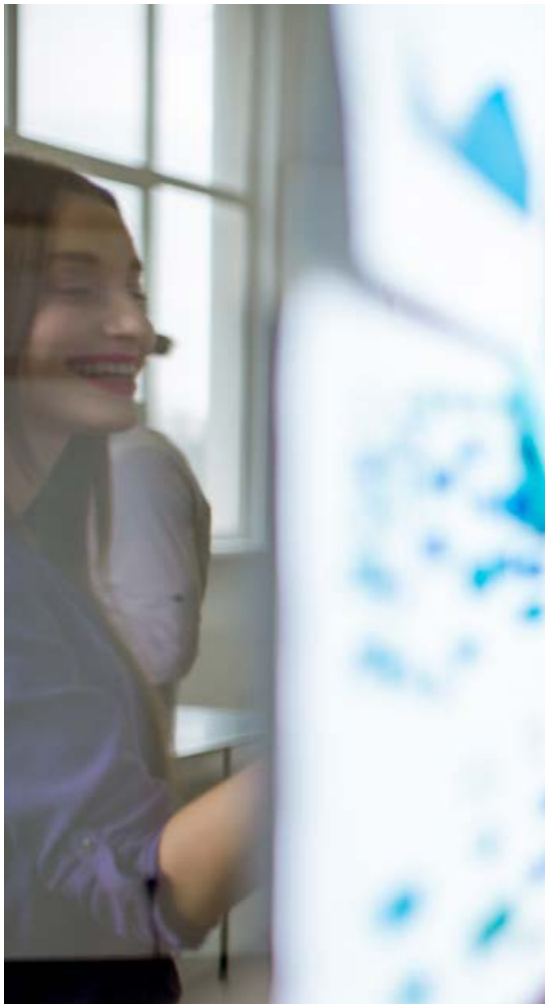
It should be remembered that the subject matter of such an assessment may not only be limited to the amount of the transfer price but it may also include the ability of the transaction parties to fulfil a given function and to assume the risk related to making intangibles available. For it is not so that the legal owner of a given intangible is – in each case – the only entity entitled to receive the profits relative to its exploitation – the entities performing the functions, engaging the assets or assuming the risks which may contribute to the growth of the value of such an intangible (i.e. economic owners) should also receive a part of the profits generated as a result of using a given intangible. The aforementioned principle is reflected in the provisions of the regulations on transfer pricing which stipulate that the process of examining the comparability of controlled transactions involving intangibles should also include – apart from standard comparability criteria – the assessment of the ability of the transaction parties to perform a given function and to assume a given risk in the scope of possessing the legal title, protection and maintenance, creation, development and enhancement and exploitation of intangibles (the so–called DEMPE functions (*Development, Enhancement, Maintenance, Protection and Exploitation*)).

In the context of the aforementioned, it is advisable to consider the preparation – in addition to transfer pricing analysis – of the so-called DEMPE analysis which is focused on the functions related to the development, enhancement, maintenance, protection and exploitation of intangibles. The preparation of such an analysis largely consists in reflecting of the elements from the comparability study performed by tax authorities in relation to the transactions connected with intangibles. As a result, the presentation of the results of such an analysis during the discussions with tax authorities may help in limiting the risk of challenging the payment of the amount due to the related legal owner of a given intangible.

Valuation of the unique – hard to value intangibles

The concept of hard to value intangibles ("HTVIs") is incorporated in Chapter VI of the OECD Guidelines as a tool for assessing which

"The entities performing the functions, engaging the assets or assuming the risks which may contribute to the growth of the value of such an intangible (i.e. economic owners) should also receive a part of the profits generated as a result of using a given intangible."



circumstances may be important for the valuation of intangibles and whether such type of circumstances may be rationally predicted upon the conclusion of a transaction (the so–called *ex post* assessment).

The provisions of the regulations on transfer pricing define HTVIs as the intangibles, as well as the rights to such intangibles, which – upon their transfer between related entities – did not have reliable comparable data and the forecast of future cash flows or expected revenue from such assets, or the assumptions applied for their valuation were burdened with a high level of uncertainty, which caused that the final economic result from the transfer of such intangibles was hard to determine.

The fulfilment of the conditions for considering a given intangible as HTVI results in two main consequences in the context of transfer pricing. Firstly, the comparability study process includes – in such a case – also the assessment of the transaction in terms of additional and specific criteria, such as – to give an example – the introduction of contractual clauses concerning the change of the price. Secondly, in the case of stating the difference between the forecast data and the actual data which results in the difference in the transfer price of the HTVI equal to at least 20% of the value of the transfer price calculated based on the forecast data, the tax authority is given the possibility of defining the transfer price of the HTVI on an ex post basis. Thus, the authority is not bound by the prohibition of taking into account the circumstances which could not have been known to its parties on the day of its conclusion and which – have they been known – could have caused the assessment of the higher or lower value of the subject matter of such a transaction by the parties.

In practice, the aforementioned regulation forces taxpayers to prepare accurate and reliable forecasts being the grounds for determining the transfer price in the transactions involving HTVIs as well as their verification in terms of possible differences with the actual data.

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The regulations which became effective on 1 January 2019 have provided the tax authorities with new tools which enable them to perform a more detailed analysis of the terms and conditions of the transactions involving intangibles with related entities. We should also expect further regulation of such issues in our provisions following the development of the DEMPE concept introduced by the OECD. It is advisable to remember the above when fulfilling the documentation and reporting obligations in the scope of transfer pricing.

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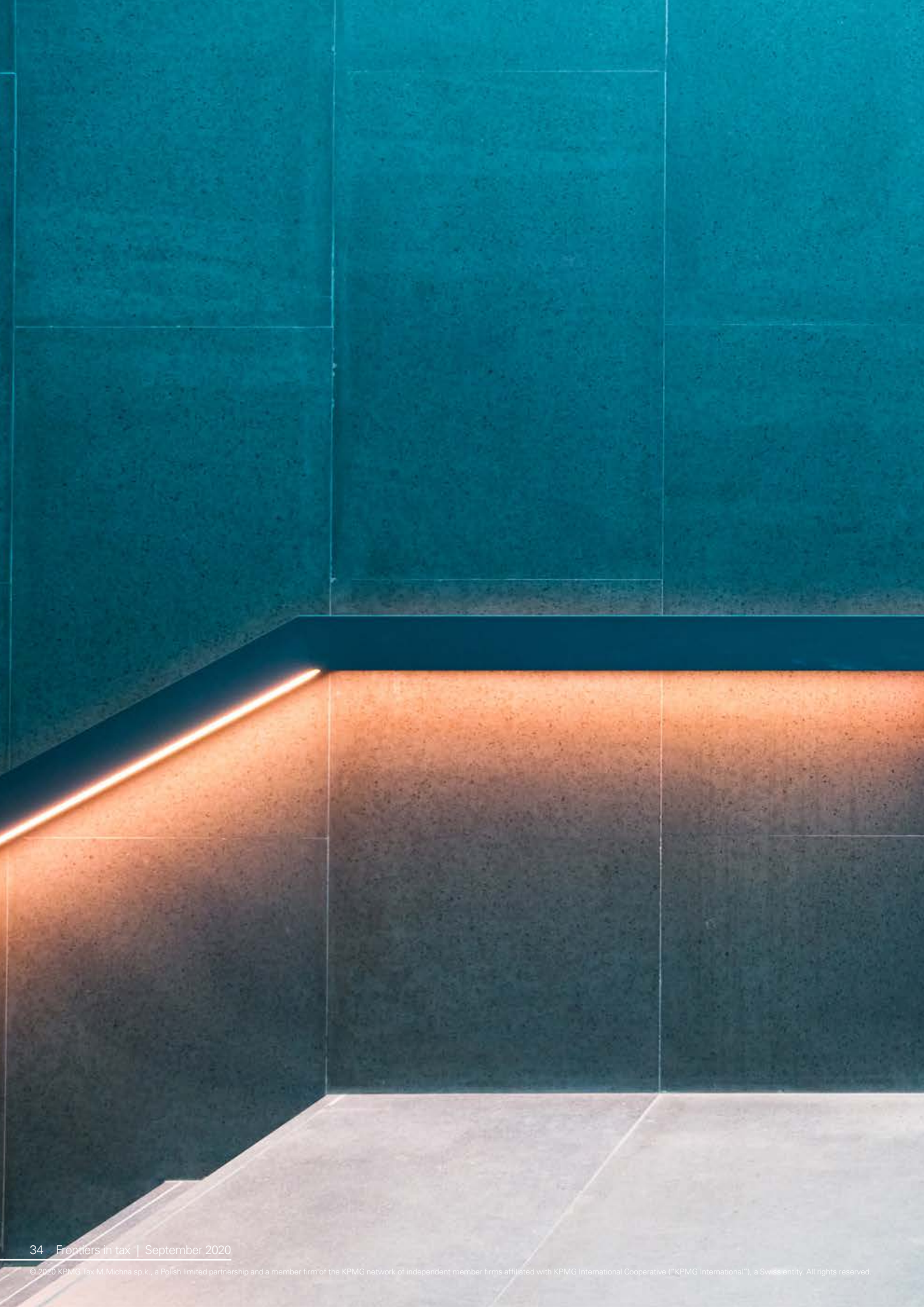

How to apply Article 15e of the CIT Act in business activities based in Special Economic Zones?

It may seem that the issue connected with the interpretation and application of provisions of Article 15e of the CIT Act in group settlements concerning the intangible services no longer creates greater difficulties. Yet, the observation of the line of decisions issued by courts and tax authorities casts more doubts. This time, they refer mainly to taxpayers operating in Special Economic Zones (SEZ).

Since the introduction of Article 15e to the CIT Act as of 1 January 2018, the possibility of recognising certain expenditures incurred for related entities or entities from the countries applying harmful tax competition as tax deductible costs has been limited.

In compliance with the actual legal state, the taxpayers operating in capital groups are obliged to exclude the expenditures for acquisition of intangible services from tax deductible costs, such expenditures being – to give examples – advisory, management and control services, advertising services, or the expenditures for obtaining guarantees or sureties up to the statutory limit of PLN 3 million and 5% of the EBITDA.

The opportunity for avoiding the aforementioned limitations is that the taxpayers obtain the decision concerning the Advance Pricing Agreement (APA) which confirms that the method and manner of calculation of the aforementioned costs comply with the arm's length principle. Having such a decision issued is the basis for the deduction of the costs under Article 15e of the CIT Act in their entirety, without the application of the limit provided for in the provision.

The issue of classification of the services subject to Article 15e of the CIT Act and the issue of calculation of the limit were the subject matter of numerous interpretations and judgements, which – in the end – creates a relatively uniform line of interpretation.

Yet, the taxpayers who run business activities outside and inside special economic zones and thus take advantage of the income exemption from the tax (CIT) on account of the business activity covered by a relevant permit still encounter numerous doubts as to the application of the limitation of Article 15e of the CIT Act.

Where's the problem?

In compliance with the wording of Article 15e (4) of the CIT Act, the provisions of Article 7 (3) of the CIT Act are applicable to the revenues and costs referred to in Article 15e (1) of the CIT Act, i.e. the provisions stipulating that the assessment of taxable income should not take into account, among others, the revenues from the sources exempt from the tax and the tax deductible costs relative to those revenues. Pursuant to Article 17 (1) (34) or Article 17 (1) (34) (a) of the CIT Act, the taxpayers operating in the SEZ take advantage of such an exemption.

Thus, the question has arisen whether the SEZ–based entrepreneurs should – when calculating the limit under Article 15e of the CIT Act – take into account the revenues and costs connected only with the taxable business activities or – pursuant to the same rules as other non-SEZ entities – the entirety of the revenues and costs. This issue has become the subject matter of interpretations and judgements issued by voivodeship administrative courts which are not uniform.

Current line of interpretation

The line of judicial decisions differs depending on the instance. The position of tax authorities is basically different from the approach presented by the majority of administrative courts.

The opinion of the Head of the National Revenue Information presented in the issued individual interpretations (e.g. dated 14 January 2020, records No. 0111-KDIB2-1.4010.499.2019.2.PB, dated 10 July 2019, records No. 0111-KDIB1-2.4010.216.2019.1.BG, dated 12 December 2018, records No. 0111-KDIB1-3.4010.552.2018.1.MST) reveals that the taxpayers operating in the SEZ should assess the revenues and tax deductible costs pursuant to the same rules as other entities that do not run business activities in Special Economic Zones. Only the income generated by them – provided that certain conditions are fulfilled – may be subject to exemption from taxation. Therefore, in order to calculate the

> Yet, the taxpayers who run business activities outside and inside special economic zones and thus take advantage of the income exemption from the tax (CIT) on account of the business activity covered by a relevant permit still encounter numerous doubts as to the application of the limitation of Article 15e of the CIT Act.

income, it is necessary to assess the tax deductible costs while taking into account the limitations arising from Article 15e of the CIT Act.

A similar position was adopted by the Voivodeship Administrative Court in Gliwice in the judgement dated 25 March 2020 (records No. I SA/Gl 1299/19) which also referred to the historical interpretation, stating that the regulations concerning the exemption from taxation of the SEZ-based income had been adopted earlier in the regulation on cost limitation and that the legislator – when introducing Article 15e of the CIT Act – did not provide for any special rules for SEZ-based entities.

Whereas, a different position is taken by the majority of administrative courts (Voivodeship Administrative Court in Wrocław, dated 16 July 2019, records No. I SA/Wr 356/19, Voivodeship Administrative Court in Cracow, dated 10 July 2019, records No. I SA/Kr 577/19, Voivodeship Administrative Court in Gdańsk, dated 8 May 2019, records No. I SA/Gd 439/19), which generally emphasise that:

- the costs which are allocated to the revenues from the business activities run within the SEZ should be excluded from the costs subject to limitation (the limitation should apply only to the costs of intangible services connected with the taxable business activity);
- a taxpayer running business activities in the SEZ should calculate the EBITDA limit only on the basis of revenues and costs relative to the taxable business activity;
- the application of the regulations concerning the limitation of the costs in the SEZ seems to be unjustified since ultimately this type of income is exempt from taxation.

What to do next?

All judgements cited hereinabove (together with the judgement of the Voivodeship Administrative Court in Gliwice) are not final and binding, and the line of interpretation which is not uniform will be settled most likely by a judgement issued by the Supreme Administrative Court. The issue of stating which approach to the application of Article 15e of the CIT Act by the entrepreneurs operating inside and outside the SEZ will be more beneficial is ambiguous as well. The aforementioned depends on, among others, the value of intangible services acquired from related entities or the value of the income exempt from taxation and taxable income.

When observing the portfolio of the taxpayers operating in the SEZ, it may be noticed that a majority of them are entities operating in big capital groups for which the purchase of intangible services from related entities is often a significant transaction. Therefore, the decisions as to further steps should be made individually by such taxpayers, after prior calculation of the influence of those three variables on their situation, as well as the possibility of selecting the most beneficial solution in terms of taxation. Nevertheless, it seems – at present – that the optimum solution in such a case is to file a request for being issued an individual interpretation.

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Do you conclude transactions with related entities? Expect inspections

The issue of transfer pricing is currently a hotly discussed tax aspect. It takes various forms – active work undertaken by working groups at the Ministry of Finance, amendments to legal regulations resulting in increasingly strict obligations and an increased number of inspections performed by tax authorities.

Tax authorities are not going to slow down

The data made available by the Ministry of Finance shows that in 2019 there were 471 inspections performed in relation to transfer pricing, which means an increase of about 76% in comparison with 2018. In 2018–2019, the number of inspections concluded with an upward adjustment increased as well (139 in relation to 193). Furthermore, in 2019, as a result of inspections, the amount of the charged income tax exceeded PLN 450 million and was twice as high as that of 2018. The foregoing information shows that in recent years, we have been observing not only an increase in the number of completed inspections but also (or probably first of all) their much higher effectiveness. It should be noted that thanks to the introduction of new tools (CIT-TP/PIT-TP information filed for 2017–2018 and the TPR form filed since 2019), tax authorities obtained access to detailed data concerning the transactions effected with the related entities. We can conclude that the information provided enables the precise selection of the entities for control as well as improves the efficiency of the activities undertaken by tax authorities.

Who may expect transfer pricing inspections?

Our experience shows that the selection of taxpayers to be inspected is currently of great importance. Tax authorities analyse the information provided by taxpayers in CIT-TP/PIT-TP forms (and since 2019 in the TPR form) in a detailed way. The risk of inspection is the highest for the taxpayers who declare the conclusion of transactions which – by their very definition – may raise doubts of the authorities, for example financial, service transactions or transactions linked to the gratuitous provision of services. Furthermore, year by year, the tax authorities – for the purposes of transfer pricing inspections – continue to be highly interested in the taxpayers fulfilling the following criteria, to name but a few:

- high dependence of income on intra-group transactions,
- conclusion of significant transactions with entities having their registered offices in countries applying harmful tax competition,
- high share of costs of intangible services and financial costs in the costs of operating activities,
- recognition of loss in a given year or repeated recognition of losses in the subsequent years,
- rapid reduction of profits or achievement of lower profitability than the competitive entities in a given industry, especially in the case of a positive assessment of the undertaking's efficiency, e.g. growth in revenues,
- completion of restructuring processes.

In addition, attention should be paid to the activities of the Transfer Pricing and Valuation Department at the Ministry of Finance, which employs numerous qualified specialists. Their competence includes the development of tax administration policy in the scope of transfer pricing, the undertaking of activities aimed at creating new regulations and the provision of explanations in relation to their application. When relevant authorities select taxpayers for control, they also take into account the conclusions arising from the expert opinions prepared by the said department.

> Tax authorities analyse the information provided by taxpayers in CIT-TP/PIT-TP forms (and since 2019 in the TPR form) in a detailed way.

Preparations for inspection

First of all, it should be emphasised that transfer pricing documentation, which is a fundamental document during an inspection, cannot be drawn up at the last moment. It is the first source of information about a transaction or the functional profile of the taxpayer and gives tax authorities significant grounds for drawing conclusions. Therefore, it is so important to include therein information which complies with the actual state. It should also be remembered that the preparation of transfer pricing documentation is a complex process, very time-consuming, and often requiring the involvement of many employees. For that purpose, it is necessary to perform a detailed review of all transactions and business events effected with related entities and countries applying harmful tax competition in terms of their compliance with transfer pricing regulations.

At the beginning, it is necessary to identify all business partners being related entities or having their registered offices in tax havens, and then prepare a list of all transactions concluded with such undertakings, taking their value into account. Only on that basis it is possible to define the transactions for which the statutory limits imposing the obligation to prepare the documentation complying with the provisions of the CIT Act have been exceeded. Attention should also be paid to the terms and conditions being the grounds for the conclusion of the transactions, with special emphasis placed on those which generate loss, are not economically profitable, or do not have a business justification. They are the ones which will certainly be of greatest interest to the inspecting authorities. Such an analysis should result in the assessment whether the transactions concluded with related entities or the entities having their registered offices in countries applying harmful tax competition are justified and consistent with internal principles, e.g. with transfer pricing policy.

The next stage of preparations for a possible transfer pricing inspection should be the careful preparation of transfer pricing documentation, with special attention paid to its coherence with the transfer pricing policy, concluded agreements, and the actual terms and conditions of transactions. We would like to emphasise that the legal system effective since 2019 provides for some transactions, e.g. restructuring, additional requirements exceeding the elements of the standard Local File (this issue is discussed in detail in a separate article in this publication entitled "Restructuring – definition and methods of its documentation"). At the same time, it should be noted that the preparation of transfer pricing documentation in a manner limited only to the fulfilment of the formal requirements stipulated in the CIT Act is not sufficient. Certainly, such requirements are extremely significant but they comprise only one aspect of correctly prepared transfer pricing documentation. The documentation should reflect – in a precise manner – the economic terms and conditions agreed by and between the business partners in a given transaction. The functional analysis or the price calculation method which is not in compliance with the actual state significantly increase the risk of challenging the terms and conditions of the transaction and the probable upward adjustment of tax.

Furthermore, it should be remembered that the tax regulations effective from 1 January 2019 stipulate that the preparation of the benchmarking analysis is obligatory for all entities obliged to prepare the Local File (the only exclusion are the transactions to which safe harbour provisions are applicable, provided that strictly defined terms and conditions are fulfilled). The essence of performing the benchmarking analysis is to present the arm's length terms and conditions for similar transactions through the comparison of data concerning the transactions concluded by and between the related entities and the data concerning the independent entities. It should also be emphasised that in view of the regulations effective since 2019, the Local File should include the comparison of our transaction with the results of the performed analysis and justify any deviations in that scope. Such amendments are aimed at ensuring and confirming that a given transaction complies with the arm's length principles. And thus, the new regulations have introduced the next obligatory element of the documentation which requires considerable preparations and a significant involvement on the taxpayer's part.

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Intensified activities of tax authorities in Poland lead to the conclusion that an increased number of transfer pricing inspections may be expected in the coming years and that they will be more restrictive and effective. Therefore, it is necessary to remember that the preparations for the possible inspection include at least the drawing up of thorough transfer pricing documentation and a benchmarking analysis justifying the information provided in CIT-TP/PIT-TP or TPR forms. However, the only effective way of securing transfer pricing is an advance pricing agreement (APA) as only this document may constitute the real protection of the taxpayer against the possible questioning of the arm's length nature of the transactions by tax authorities and against the upward adjustment of the income.

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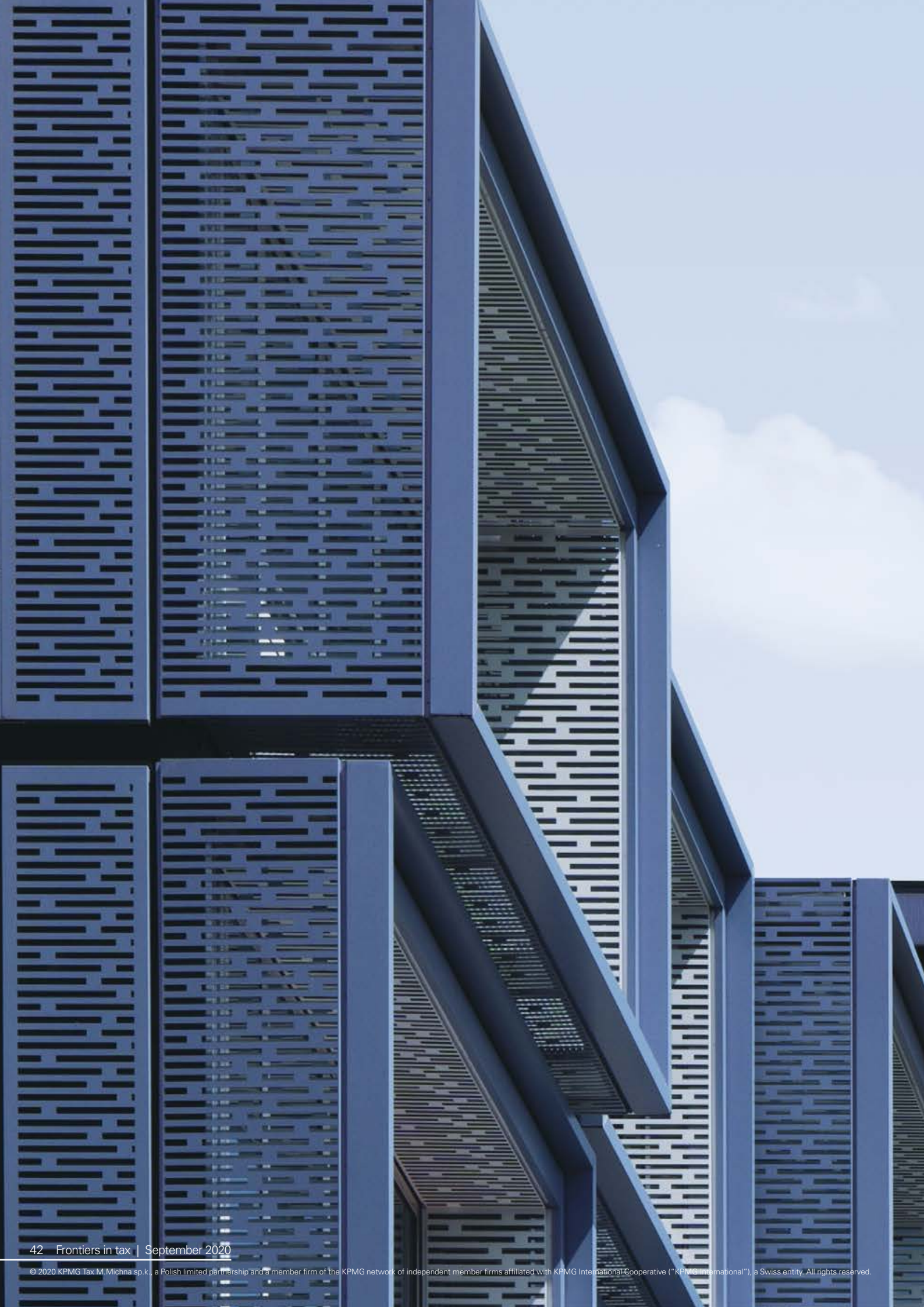

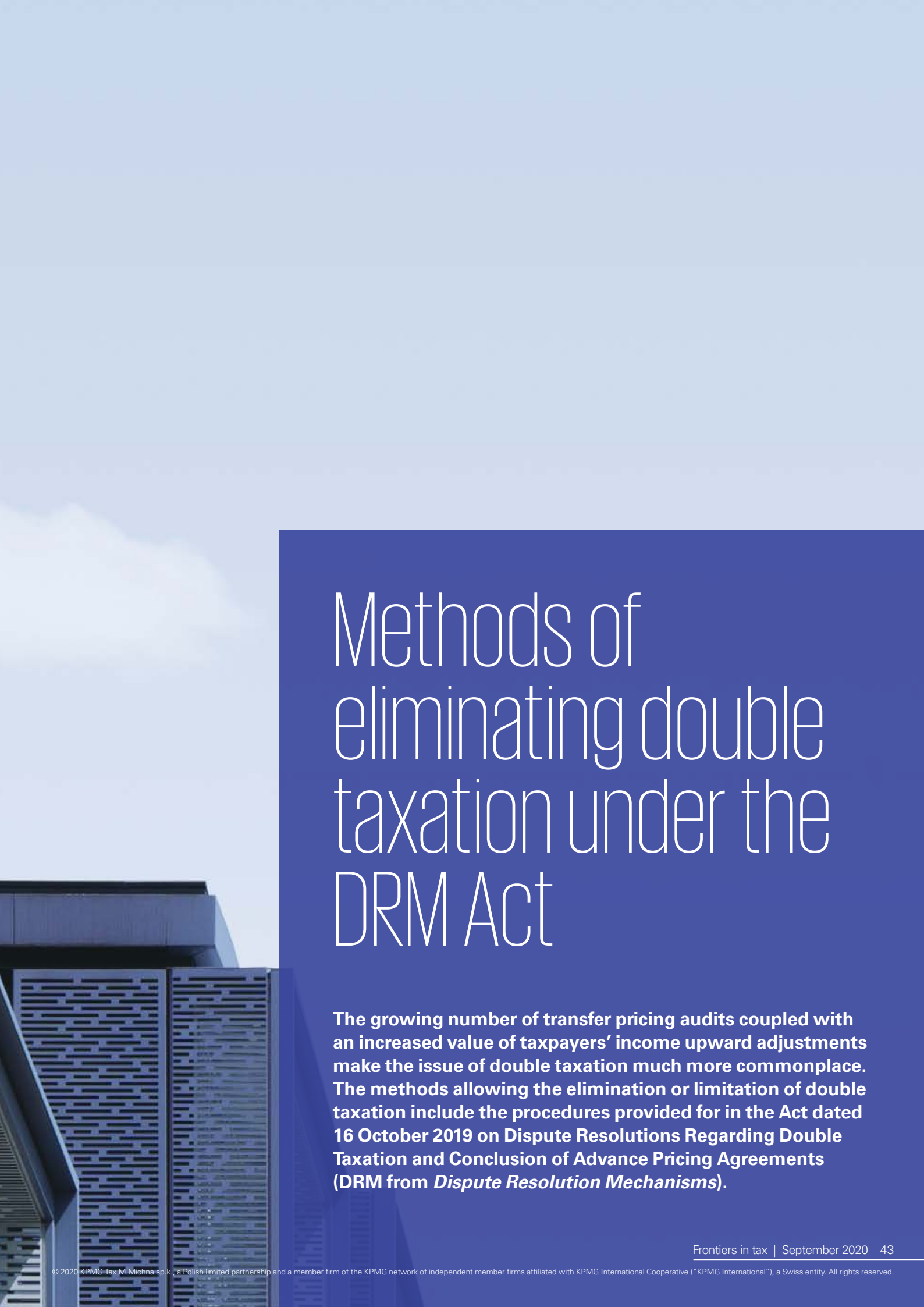

Methods of eliminating double taxation under the DRM Act

The growing number of transfer pricing audits coupled with an increased value of taxpayers' income upward adjustments make the issue of double taxation much more commonplace. The methods allowing the elimination or limitation of double taxation include the procedures provided for in the Act dated 16 October 2019 on Dispute Resolutions Regarding Double Taxation and Conclusion of Advance Pricing Agreements (DRM from *Dispute Resolution Mechanisms*).

A new procedure for international dispute resolution

The DRM procedure has been defined by the legislator as the procedure for resolution of disputes regarding double taxation between the member states of the European Union. The procedure was introduced to the Polish legal system as a result of implementing the Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union. The DRM procedure is applied in disputable issues concerning the income or property obtained in the tax year beginning after 31 December 2017, which currently significantly limits the number of disputes to which it may be applied.

The DRM procedure introduces the effective time and institutional frameworks as well as the rules concerning a request for the institution and performance of the Mutual Agreement Procedure (MAP). If the need be, the procedure provides for the appointment of an advisory commission or a commission for pre-judicial dispute settlement consisting of independent arbitrators. The DRM procedure ensures uniform guarantees in the scope of settling disputable issues, new means of appeal, and interactions with domestic proceedings.

What is important, the submission of the request under the DRM procedure precludes the possibility of submitting the requests in other manners and results in the withdrawal of the requests submitted earlier based on other procedures.

Other procedures for international dispute resolution

In addition to the DRM procedure mentioned hereinabove, there are two other grounds for submitting the request for institution of the MAP procedure.

1. The convention on the elimination of double taxation in connection with the adjustments of profits of associated enterprises, also referred to as the Arbitration Convention, which – similarly to the DRM procedure – makes it possible to resolve disputes concerning double taxation between the member states of the European Union.
2. Agreements on the avoidance of double taxation concluded by Poland.

It should be noted that the Arbitration Convention includes the mechanisms which obligate the States participating in the MAP procedure to eliminate double taxation. The agreements on the avoidance of double taxation concluded by Poland do not provide for such a beneficial solution. The filing of the appeal provided for in the regulations effective in a given country in a case covered by the request for mutual agreement does not prevent the settlement of the case under the MAP procedure. However, the final and binding judgement issued by the court will be binding upon the Minister of Finance of the interested state in the scope of assessment of a given case.

The MAP is a deformalised procedure which is not subject to any administrative fee. The duration of the procedure depends on the manner of its institution, cooperation with foreign tax authorities, receipt of information from tax authorities, and provision of additional information necessary to carry out the procedure. The request for MAP should be filed within three years of the day of the first notification to a domestic related entity or an entity related thereto about the activities of tax authorities which will or may result in double taxation. The request for MAP is considered as filed before the deadline if the request that does not include any formal deficiencies has been filed before the expiry of the three-year time limit.

An important benefit arising from the MAP procedure in comparison with the traditional way of appeal, that is the appeal against an administrative decision or filing the appeal with the administrative court, is the possibility of eliminating the economic double taxation for the transactions challenged by tax authorities. There is no possibility of further appeal against the final agreement made by and between the relevant tax authorities of the States. It should be remembered that the request for the resolution of disputes regarding double taxation should specify one of the three settlement procedures for the disputes regarding double taxation to which it relates.

Unilateral adjustment

The grounds for making a unilateral adjustment are provided for in the Arbitration Convention, agreements on avoidance of double taxation and the DRM Act. A unilateral adjustment may be made by the Polish Minister of

“What is important, the submission of the request under the DRM procedure precludes the possibility of submitting the requests in other manners and results in the withdrawal of the requests submitted earlier based on other procedures.”

Finance in order to eliminate double taxation of income of related entities when:

1. the terms and conditions defined by the tax administration of another state are in compliance with the terms and conditions that would be agreed by independent entities;

2. a domestic related entity and a foreign related entity give their consent that the tax administration of another state includes the income of the domestic related entity in the income of the foreign related entity and taxes the said income in an appropriate manner.

The request for making a unilateral adjustment may not refer to a tax liability which has become statute-barred in compliance with the provisions of the Tax Ordinance, or when the case has been earlier resolved in one of the MAP procedures, or when the request has been filed under one of such procedures. The Arbitration Convention, agreements on avoidance of double taxation and the DRM Act do not provide for the deadline for filing the request for making a unilateral adjustment.

Amendments to other procedures introduced in the DRM Act

The DRM Act regulates not only the dispute resolution procedures described hereinabove but also issues concerning advance pricing agreements (APAs), and it also introduces a new mechanism of cooperation with tax authorities in the form of an agreement on cooperation in relation to taxes included in the scope of competence of the National Revenue Administration. Let us hope that the regulations in question will actually enable the taxpayers to solve the double taxation disputes in a more efficient way.

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KPMG's 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 Barometer of Automotive Managers' Sentiment

The survey conducted by the Polish Automotive Industry Association and KPMG in Poland in May and June 2020 can be considered as the mood barometer for managers from the automotive industry. The survey's objective is to obtain information about the opinion of managing staff in automotive companies about the current and future situation in this industry in Poland. The survey was addressed to the managers of production companies and distributors of vehicles, trailers and semitrailers, structures and sub-assemblies, parts and accessories.

Cybersecurity barometer. Towards cloud-based solutions

The report is the third edition of the survey conducted by KPMG in Poland aimed at obtaining information about the dynamics and characteristics of cyber attacks and the readiness of Polish companies' for such threats. The most recent report was created based on the CATI Survey (Computer Assister Telephone Interview) among the persons responsible for IT security in companies (members of management boards, Security Managers, presidents, IT Managers, or other persons responsible for that particular area).

Automotive industry. Q2/2020 Edition

The report belongs to the series of quarterly reports which are aimed at presenting the current trends in the Polish automotive industry, including automotive retail, manufacturing and financial services. The analysis is based on the most recent registrations, statistics and market data. The publication is a joint undertaking of the Polish Automotive Industry Association and KPMG in Poland.

PIT 2019 – Poles' annual tax returns

The report was prepared based on the CATI Survey (Computer Assister Telephone Interview) on a representative sample of 1,000 adult Poles. The questions were answered by the persons obliged to file tax settlements for the year 2019 with tax offices. The respondent group did not take into account the persons whose tax returns were prepared and filed by the Social Security Institution. The survey was conducted between 6 and 18 March 2020 by Norstat, an entity conducting the surveys. The goal of the survey was to gather information about the methods of settlement of tax income for the year 2019 by Poles.

We encourage you to read KPMG publications on **business security during the COVID-19 pandemic** and see how KPMG experts can support your business in this difficult time. Do you have any question? Send an e-mail to: **mampytanie@kpmg.pl**. An expert in the field will immediately answer your inquiry.

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