KSP TAX NEWS 09/2013

We are pleased to present you KSP Tax News, in which we describe selected rulings passed in August 2013. We hope this publication proves useful in your everyday operation.

Substantive scope of tax documentation – a verdict by Province Administrative Court of Warsaw

The Province Administrative Court *[WSA – Wojewódzki Sąd Administracyjny]* of Warsaw in the judgment of 28 August 2013 (file III SA/Wa 3335/12) held that the obligation to prepare the transfer pricing documentation applied only to those transactions made between related parties that may lead to generation of revenue, income and cost with respect to CIT, i.e. transactions that triggered tax consequences.

In the case at hand, the taxpayer was a State Treasury-owned joint stock company operating within a capital group. In connection with a new investment project, the company was engaged in capital transactions with related parties. The transactions consisted in taking up shares of new issue in the Company by the State Treasury in return for an in-kind contribution in the form of shares in a related party or in acquisition by the Company of shares in subsidiaries in return for a cash contribution. The taxpayer's doubts applied to the issue of preparation of transfer pricing documentation for this type of transactions. The Company was of the opinion that acquisition of shares in return for a cash contribution did not trigger tax consequences for the Company until the Company sold the shares, and therefore no documentation needed to be drawn up for the transactions. The tax authority, in an individual interpretation, considered this standpoint erroneous, and held that for the purpose of documentation, a transaction was each activity leading to a transfer of ownership or passing of tangible or intangible goods, as well as extending loans (credits), provision of services and implementation of joint undertakings. The WSA of Warsaw, having examined the complaint lodged against the interpretation, disagreed with the tax authority and stated that not every legal relationship between two related parties was a transaction for which documentation had to be made.

Expert Comment

Proper understanding of the term "transaction" is of key importance for accurate fulfillment by the taxpayer of the obligation to prepare the tax documentation. In the situation at hand, the WSA of Warsaw stated that the provisions of Article 9a, Article 11 and Article 19(4) of the CIT Act should be considered jointly. Thus, the Court resolved that the obligation to prepare the documentation applied to transactions that caused tax consequences in the form of generation of revenue, income or costs, since the penalty tax rate of 50%, as provided for in Article 19(4) of the CIT Act, was applicable to such transactions only. The Court was of the opinion that transactions made by the taxpayer in connection with restructuring did

Michał Wilk
Tax Advisor in KSP

E: michal.wilk@ksplegal.pl
T: +48 32 731 6869

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not bring about tax consequences, and therefore the provisions of Article 19(4) of the CIT Act were not applicable to them, and hence they were not subject to the obligation to document. The judgment delineates the boundaries for transactions that need to be documented for tax purposes. The arguments used in the judgment can be helpful in the course of disputes with authorities, intended to establish which transactions were subject to taxation and which were not. However, it needs to be emphasized that the documentation has a protective function for the taxpayer.

Whenever in doubt, preparation of the documentation is recommended with a view to secure the taxpayer against the tax risk. It applies in particular to restructuring processes in related parties. As of 18 July 2013, specific regulations were implemented with respect to the Ordinances by the Minister of Finance concerning transfer prices, which provide for the manner of auditing by tax authorities of compliance with the arm's length principle when it comes to prices used in transactions connected with restructuring of operations (e.g. transferring production to another company, selling a material part of assets, etc.). Therefore, the authorities will be very careful dealing with this type of transactions".

CIT

The Supreme Administrative Court *[NSA - Naczelny Sąd Administracyjny]* in the judgment of 9 August 2013 (file II FSK 2433/11) held that assessment by tax authorities of revenue from receipt of shares in a capital company in return for a contribution with the share premium was only possible if the market value of the shares was significantly different from the market value of the subject of the contribution.

The taxpayer intended to make a non-pecuniary contribution to a daughter company located in Cyprus. The contribution had the form of the right to a registered trademark. In return for the contribution, the taxpayer was to be given shares in the Cypriot company to the nominal value lower than the market value of the right to the trademark. Consequently, the transaction was to involve a surplus of the value of the contribution over the nominal value of the shares to be taken up in the Cypriot company (share premium), which was to be transferred to the reserve capital of the Cypriot company. NSA was of the opinion that the provisions of the CIT Act straightforwardly stipulated how to calculate the taxable revenue in this situation. According to Article 12(1)(7) of the CIT Act, revenue was the nominal value of shares (stock) in a capital company or contributions in a cooperative, taken up in return for non-pecuniary contribution in a form other than an enterprise or an organized part thereof. Thus, the market value of the shares will not constitute revenue. However, the Court indicated that when the market value of shares was significantly different from the market value of the subject of contribution, the tax authority might apply the regulation under Article 14 of the CIT Act which requires that revenue from the sale of property rights be determined in the amount corresponding to their market value.

The NSA in the judgment of 7 August 2013 (file II FSK 2409/11) held that interest on buyer credit extended to a company by its shareholder is also subject to the limitations resulting from thin capitalization.

For the purpose of its business activity, the Company leased real property whose owner was one of the shareholders, holding 50% of its shares. The Company intended to purchase a share in the real property, but it did not want to incur a bank

KSP Legal & Tax Advice
ul. Chorzowska 50
40-121 Katowice

T: +48 32 731 68 50
F: +48 32 731 68 51

E: kancelaria@ksplegal.pl
www.ksplegal.pl

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loan for this purpose. Therefore, in the agreement with the shareholder, the payment of the amount due was spread into 20 equal installments to be paid for the period of 20 years. The interest on the unpaid principal was calculated each year, and payable on a quarterly basis. The Company applied for an individual interpretation in order to confirm its standpoint whereby the restriction on thin capitalization was not applicable to the interest to be paid, since the debt was not a loan or credit extended by the shareholder within the meaning of Article 16 (1)(60) of the CIT Act. The tax authority, in an interpretation, disagreed with the Company's standpoint and stated that the notion of a "credit" within the meaning of Article 16 (1)(60) of the CIT Act, also included the buyer credit which was actually extended to the Company by its shareholder. The interpretation was considered accurate by the WSA of Lublin and the NSA, which considered the complaint lodged by the Company. The courts expressed the opinion that no definition of the term of "loan/credit" in Article 16(1)(60) of the CIT Act meant that the linguistic interpretation had to be used, whereby a loan did not only encompass a bank loan but every other form of debt used in trading. Thus, the notion also included the buyer credit, commodity credit or trade credit, as well as each postponement of payment or spreading the payment into installments. The judgment is consistent with the line of verdicts passed by the administrative courts, in which the notion of the "value of debt" and "loan or credit" for the purpose of thin capitalization was to be understood broadly.

The NSA in the judgment of 21 August 2013 (file II FSK 2452/11) held that compensation paid by the lessee for excessive use of the leased machine constituted deductible cost for the lessee.

In the situation at hand, the taxpayer leased machines used in construction which was the object of the taxpayer's business activity. As a result of a series of interconnected contracts concluded also with other entities, the lessee was obliged to pay compensation if the machines were used for more hours than the agreed limits (the extent of wear and tear was important, as the machines were to be subsequently sold). The settlement of the excessive time of use of the machines was to be made at the end of the term of the contract, since at the time of its conclusion, the taxpayer was not in a position to anticipate whether the hourly limits imposed on the use of the machines would be exceeded and to what extent. If the lessee wished to avoid accounting for the time of use of the machines after the end of the contract, it would have to pay higher lease fees throughout the term of the contract. Therefore, the taxpayer applied for an individual interpretation to confirm its opinion that the compensation to be paid for the excessive hours of use of the leased machines could be recognized as deductible costs. The Head of the Tax Chamber of Warsaw disagreed with the taxpayer and stated that there was no connection between the compensation paid and the revenue derived. However, this interpretation was reversed by the WSA of Warsaw, as a result of examination of a complaint lodged by the taxpayer, and the judgment was sustained by the NSA. The courts of both instances confirmed that even if it is difficult to establish a direct link between the expenses and specific revenue, purposeful and reasonable expenses related to business activity may be recognized as deductible costs. The above judgments prove that administrative courts are consistent in defending the taxpayer's right to recognize as tax deductible those expenses that are reasonably justified, purposeful and linked to business activity, although they cannot be linked to any specific revenue.

KSP Legal & Tax Advice
ul. Chorzowska 50
40-121 Katowice

T: +48 32 731 68 50
F: +48 32 731 68 51

E: kancelaria@ksplegal.pl
www.ksplegal.pl

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Head of the Fiscal Chamber of Katowice, in the individual interpretation of 2 August 2013 (file IBPBI/2/423-579/13/SD) stated that expenses incurred to construct road infrastructure on lands owned by the commune, intended to ensure access to the taxpayer's enterprise, may constitute deductible costs for the taxpayer.

The company intended to construct a wind farm, but for the project to be accomplished it was necessary to build an access road to the farm. The road could be constructed on lands owned by the commune, which the Company had no legal title to. According to the Public Roads Act of 21 March 1985, the road could be constructed based on an agreement with the commune. In the light of the rules laid down in said Act, after the enterprise has constructed the road infrastructure at its own expense, the infrastructure was to be transfered to the commune gratuitously, i.e. with no remuneration or reimbursement of costs. The road thus built remained a public road available to be used by the general public. The Company applied for an individual interpretation and asked whether it could recognize the expenses incurred to construct the infrastructure as indirect deductible costs, and whether the time of recognition of the expenses was the date of transfer of the constructed road to the commune. The Company believed that a close link between the plan to start up the project of a wind farm and construction of the access road was sufficient ground for recognizing the costs of the construction as deductible costs on the date of transferring the infrastructure to the commune. No fixed asset will be created as a result of the construction, and no investment in third party's fixed asset will occur, and therefore, the expenses incurred will not be subject to depreciation. The recognition of the date of transfer of the finished road to the commune against a transfer certificate as the date on which the cost was recognized in the books of account was justified by the fact that it was only after completion of the construction that all the costs and expenses can be calculated. In the interpretation issued by the Head of the Fiscal Chamber of Katowice, the Company's standpoint was considered accurate. The above means that entrepreneurs can recognize expenses necessary for an investment in road infrastructure built on third party's land as deductible cost on a one-off basis, which road will ultimately be gratuitously transferred to be owned by the commune, and the entrepreneur will not derive any profits therefrom (e.g. through exercising management of the road). The only condition for recognizing the expenses as costs is their link with revenue derived by the entrepreneur.

The NSA in the judgment of 2 August 2013 (file II FSK 2421/11) held that in the situation when a debt is acquired, the revaluation allowances made by the debt seller with respect to the purchased debts and debts defined as non-collectible could not be recognized as deductible costs.

In the situation at hand, the bank's activity involved, amongst other things, acquisition from other banks of debts resulting from credits or loans. The bank was of the opinion that it was authorized to classify as deductible costs the revaluation allowances on debts thus acquired and debts written down as non-collectible. The NSA held that this approach was not justified in the light of legal regulations. In the case of debt assignment, no succession of tax-related rights and obligations occurs. Therefore, the buyer of the debt cannot acquire the tax-related rights which the seller would be entitled to, such as the possibility to recognize deductible costs.

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ul. Chorzowska 50
40-121 Katowice

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F: +48 32 731 68 51

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www.ksplegal.pl

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VAT

The WSA of Warsaw in the judgment of 14 August 2013 (file III Sa/Wa 853/13) analyzed the notion of "financing from public funds" in order to apply the VAT exemption with respect to the services of vocational training or re-qualification.

The company operating in the field of IT education rendered to another entity (the Principal) the service of providing lecturers to deliver training. The training was administered as part of a project co-financed from the European Social Fund. Also, the costs of remuneration for the Company paid by the Principal were funded from the aid funds. The Company applied for an individual interpretation to obtain an answer to the question of whether the services provided to the Principal were VAT-exempt under Article 43 (1) (29) of the VAT Act as the vocational training or vocational re-qualification services financed from public funds in at least 70%. The Head of the Fiscal Chamber of Warsaw, in the interpretation, stated that in the situation at hand the condition of "financing from public funds" was not fully complied with, as the direct beneficial owner of the co-funding from the aid funds was the Principal rather than the Company. Thus, the services it provided were subject to 23% of VAT. The Company disagreed with this interpretation and lodged a complaint against it with the WSA of Warsaw. Having examined the case, the Court revoked the interpretation and shared the Company's standpoint whereby Article 43(1)(29) of the VAT Act contained no restriction that it was the direct beneficial owner of co-financing only that could apply the exemption. The court was of the opinion that irrespective of the number of entities and levels of transactions, the funds thus transferred were still public funds. The above judgment indicates that the notion of financing from public funds is to be understood broadly, and the transfer of the aid funds to subsequent subcontractors completing the co-financed project was also included within the meaning of "financing from public funds". By the same token, the subcontractors can benefit from the VAT exemptions provided for in such situations, although, formally, they are not the ones that obtained the co-funding.

The WSA of Bydgoszcz in the judgment of 27 August 2013 (file I SA/BD 430/13) held that gratuitous redemption of shares in a company in return for the transfer of the right to real property was not VAT taxable.

In the situation in question, one of the shareholders of a limited liability company planned to withdraw therefrom. As part of the assets to which it was entitled, the shareholder was to receive real property. In connection with this fact, a resolution was to be adopted on voluntary redemption of shares in return for compensation in the form of transfer of the real property. The tax authority expressed the opinion that in this situation the company acted as the VAT payer, since the supply of real property to a former shareholder will occur as part of the company's business activity. Hence, the real property supply should be subject to VAT. The Court disagreed with the standpoint. It held that transfer of the in-kind compensation in return for redeemed shares was not made as part of the business activity, and thus it was not subject to VAT. The mere fact that the entity was a VAT payer did not mean that it was to be considered a VAT payer for the purpose of each activity it was involved in.

KSP Legal & Tax Advice
ul. Chorzowska 50
40-121 Katowice

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www.ksplegal.pl

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MISCELLANEOUS

The General Prosecuting Attorney, in the application of 9 August 2013 (file PG IV PA 54/13) requested that the NSA adopt a resolution regarding the issue of PIT imposed on gratuitous benefits obtained by employees due to leaving to their disposal the benefits connected with arranging for an integration event.

The General Prosecuting Attorney applied for a resolution concerning the issue of whether the costs of accommodation, board, travel and other costs incurred by the employer in order to arrange for a training and integration event and similar events were to constitute revenue from gratuitous benefits within the meaning of Article 12 (1) of the PIT Act also in a situation where, in the light of Article 11(1) of the Act, the employees did not actually receive said benefits, but these were only left to their disposal. It is another request filed by the central administrative body with the NSA for adoption of a resolution intended to clarify the discrepancies in judgments concerning taxation of extra benefits received by employees. A significant number of such requests in recent time will certainly motivate the NSA to finally resolve the issue in order to make the standpoints adopted by administrative courts more consistent.

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If you wish to be provided with additional information in this respect, please contact us.

KSP contact:

Magdalena Patryas

Partner

T: +48 32 731 68 53

E: magdalena.patryas@ksplegal.pl

KSP Legal & Tax Advice
ul. Chorzowska 50
40-121 Katowice

T: +48 32 731 68 50
F: +48 32 731 68 51

E: kancelaria@ksplegal.pl
www.ksplegal.pl

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