

THE
TRANSFER
PRICING LAW
REVIEW

Editors

Steve Edge and Dominic Robertson

THE TRANSFER PRICING REVIEW

The Transfer Pricing Review

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PRICING LAW
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Editors

Steve Edge and Dominic Robertson

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PREFACE

It has been a great honour – and an even greater education – to be asked to edit the inaugural edition of *The Transfer Pricing Law Review*.

Since the financial crisis in 2008, there has been continuous public attention on multinationals' tax position – which, for the most part, turns on their transfer pricing policy, and whether this properly aligns the taxable profits in each country with the value-generating activities taking place there. In the past couple of years, that public and political pressure has begun to turn into concrete action: for example, through the BEPS reforms on country-by-country reporting and transfer pricing; the European Commission's state aid investigations into Apple, Starbucks and others, which almost all relate to transfer pricing matters; and, as several chapters in this review make clear, increased audit scrutiny at the national level. It seems clear that transfer pricing issues will be filling tax professionals' working lives for several years at least.

This publication aims to give readers a high-level overview of the principal transfer pricing rules in each country covered. Each chapter summarises the substantive transfer pricing rules, explains how a transfer pricing dispute is handled, from initial scrutiny through to litigation or settlement, and discusses the interaction between transfer pricing and other parts of the tax code (such as withholding taxes, customs duties, and attempts to prevent double taxation).

This review contains contributions from 17 countries, covering a broad spread both geographically and economically. We are very grateful to the authors of the country chapters for lending their time and expertise to this project.

Four key themes that emerge from the country chapters are:

- a* More disputes: unsurprisingly, many countries (including Mexico and Poland) report an increase in transfer pricing disputes, particularly around profit allocation in a multinational supply chain.
- b* Profit splits: several countries (including Israel, Mexico and the UK) are seeing tax authorities push for a greater use of profit splits, particularly for high value-added activities where it may be difficult to find a precise comparable. (How you identify an appropriate share of profits for each different country is, of course, a separate challenge here.)
- c* TP compliance tools: many of the reporting countries have adopted rules that are designed to encourage greater transfer pricing compliance. Country-by-country reporting, which has been very widely adopted, is the prime example of this, but other instances include automatic transfer pricing penalties in Canada and Russia, and the diverted profits taxes adopted in Australia and the UK.

d Varied transfer pricing approaches: it is striking that different countries continue to apply transfer pricing in rather different ways. At one end of the spectrum, Brazil has rejected the OECD arm's-length principle entirely, arguing that imposing fixed ratios and limits is more effective. Even within the large majority of reporting countries that apply the OECD principles, however, there are differences in approach which could lead to diverging outcomes in practice. For example, Germany's transfer pricing rules apply a 'prudent and diligent managing director' test on top of the normal arm's-length principle (which has perhaps inspired the 'prudent economic operator' concept developed by the European Commission in their tax state aid investigations); and the Luxembourg chapter discusses a recent case in which an interest-free loan from Luxembourg to Italy resulted in taxable interest income in Luxembourg, with no corresponding deductions in Italy. These variations, of course, increase the risk of double taxation of the same profits – and it is thus important (if perhaps optimistic) that countries adopt the BEPS Action 14 recommendations on tax dispute resolution mechanisms with the same enthusiasm they have often shown for the tax-raising recommendations.

Finally, we would like to thank the publishing team at Law Business Research for their diligence and enthusiasm in commissioning, coordinating and compiling this review.

Steve Edge and Dominic Robertson

Slaughter and May

London

June 2017

POLAND

*Sławomir Łuczak and Magdalena Polak*¹

I OVERVIEW

Polish transfer pricing (TP) regulations refer to and link directly to OECD principles. Moreover, TP regulations are changing to be in line with current OECD standards: Poland has already incorporated country-by-country reporting rules (CBCR), a three-step approach to TP documentation (master file, a local file and CBCR) and guidelines on low value adding services. Despite that, OECD standards are not formally implemented as a part of Polish domestic law. However, they are a source of interpretation in practice, not only for taxpayers or tax authorities, but also administrative courts.

Polish TP regulations apply to income taxes, both corporate income tax (CIT) and personal income tax (PIT), covering corporations (legal persons or units without legal personality) and individuals. As Polish law does not recognise trusts, there are no specifics applying to them. Furthermore, there are also TP regulations implemented on the grounds of value added tax (VAT).

i CIT/PIT

Polish TP regulations provided for in the CIT² and PIT³ Acts cover a wide definition of related parties. Accordingly, a relationship between parties occurs when:

- a* a domestic entity (i.e., a natural person, legal person, or organisational unit without legal personality), having its place of residence, registered office or management board in Poland, participates directly or indirectly in managing an enterprise located abroad or in controlling the enterprise; or holds a share in the capital of the enterprise;
- b* a foreign entity (i.e., a natural person, legal person, or organisational unit without legal personality), having its place of residence, registered office or management board outside Poland, participates directly or indirectly in managing a domestic entity or in controlling it, or holds a share in the capital of the domestic entity;

1 Sławomir Łuczak is a partner and Magdalena Polak is a junior associate at Soltysiński Kawecki & Szlęzak – Kancelaria Radców Prawnych i Adwokatów Spk

2 Act dated 15 February 1992.

3 Act dated 26 July 1991.

- c* a natural person, legal person, or organisational unit without legal personality, participates at the same time, directly or indirectly, in managing a domestic entity and a foreign entity or in controlling them, or holds a share in their capital;
- d* a domestic entity directly or indirectly participates in the management or control of another domestic entity, or holds shares in the capital of another domestic entity;
- e* a natural person, legal person, or organisational unit without legal personality, participates at the same time, directly or indirectly, in managing domestic entities or in controlling them, or holds a share in their capital; or
- f* there are family relationships (marriage or a relationship or affinity to the second degree⁴), employment or property relationships between domestic entities or managerial, controlling or supervisory personnel of those entities, and if any person jointly performs managerial, controlling or supervisory functions in those companies.

Summing up, the definition of ‘related parties’ includes both a direct or indirect qualified relationship between parties, which may be:

- a* a capital relationship, which is a situation where a given entity holds – whether directly or indirectly – a share of at least 25 per cent in the capital of another entity;
- b* a relationship resulting from participation in the management or control of a given entity;
- c* a property relationship (only in the case of domestic entities);
- d* a relationship involving family ties (only in the case of domestic entities); or
- e* an employment relationship (only in the case of domestic entities).

Polish legislators have implemented a very wide definition of ‘transfer price’ since 1 January 2017. According to recent amendments, the transfer price is not only the price used in all transactions, but also other events reported in accounting books between related parties. This also includes a company deed of a company without legal personality, a joint venture agreement or another similar agreement. The definition of transfer price covers also making – whether directly or indirectly – payments of receivables to an entity having its place of residence, registered office or management board within a territory or country that applies harmful tax competition, where such payments arise out of transactions or other events, including a company deed of a company without legal personality, a joint venture agreement or another similar agreement. However, Polish legislators have not imposed TP obligations on all transactions and other events between related parties. The main criterion when identifying a taxpayer’s responsibilities is ‘a significant influence’ on the amount of related parties’ income (loss). This ‘significant influence’ also differs depending on the scale of the taxpayer’s business (met thresholds), that is, the amount of revenue or costs (within the meaning of accounting regulations) established from the maintained accounting records of taxpayer in the year preceding the given tax year.

⁴ A second-degree relative is defined as a blood relative which includes the individual’s grandparents, grandchildren, aunts, uncles, nephews, nieces or half-siblings.

The criteria regarding thresholds and significant influence amounts are presented in the table below:

Exceeded threshold	Relations with entities in tax havens	Significant influence of transactions and other events
€2 million to €20 million	€20,000	€50,000 + €5,000 per €1 million of revenue above the amount of €2 million
€20 million to €100 million	€20,000	€140,000 + €45,000 per €10 million of revenue above the amount of €20 million
€100 million	€20,000	€500,000

TP regulations also allow tax authorities to request a taxpayer to prepare and present TP documentation covering transactions or other events whose value does not exceed the limits defined as ‘significantly influencing’. The tax authority’s request may be filed only when it is likely that the value of the transaction or other event has been understated to avoid the obligation to prepare TP documentation. Tax authorities must then indicate the circumstances that justify the suspicion of understating the value of the transaction or other event.

ii VAT

A slightly different definition of related parties is provided for in the VAT Act.⁵ The qualified relationship exists when among contracting parties or persons performing management, supervisory or control functions, there are links based on:

- a family (which means marriage, consanguinity or relations to the second degree) or adoption;
- b capital (which means holding a voting right that constitutes at least 5 per cent of all voting rights or being entitled to exercise said right directly or indirectly);
- c property;
- d employment; or
- e where any of the aforementioned persons join management, supervisory or control functions performed for contracting parties.

Having mentioned the above, transfer price for VAT purposes is defined as: ‘remuneration for the supply of goods or services between a related customer and person accomplishing the supply of goods or supplier’. In this case, in contrast to CIT/PIT regulations, VAT does not recognise any thresholds and significant influence amounts.

II FILING REQUIREMENTS

As mentioned, since 2017, a three-step approach to TP documentation has been introduced in Poland. This means that depending on a taxpayer’s situation, they may be obliged to prepare TP documentation that meets the requirements of a local file, a master file or a CBCR. Besides documentation requirements, there exist other tax obligations to fulfil, depending on the taxpayer’s classification according to certain thresholds. They are calculated on the level of: €2 million, €10 million, €20 million and €750 million (revenues/costs calculated as indicated in Section I, *supra*).

⁵ Act dated 11 March 2004.

The documentation requirements and other obligations are presented in the table below:

Threshold	TP documentation	Other obligations
€2 million	<p>The taxpayer is obligated to prepare a local file, which should include:</p> <ul style="list-style-type: none"> • a description of qualified transactions or other events including: their type and subject, financial data, identification data of related parties, and an indication of the method and manner for the calculation of the taxpayer's income (loss); • a description of the taxpayer's financial data, making it possible to compare the settlements of a transaction with the data derived from the approved financial statements; • information about the taxpayer including a description of: the organisational and management structure; the subject and scope of the business pursued; the economic strategy applied, including the assignment of economically significant functions, assets, or risks having an impact on the taxable person's income (loss) made during a given fiscal year or the year preceding the given fiscal year between related parties; and the competitive environment; • documents including: contracts and memoranda concluded between related parties etc.; and the company deed of a company without legal personality, joint venture agreement, or another similar agreement, documenting the principles governing the partners' rights (parties to the agreement) to participate in profits and losses; and • arrangements pertaining to income tax made with the tax administrations of countries other than Poland, pertaining to transactions or other events including pricing arrangements. 	<p>The taxpayer is obligated to prepare TP documentation no later than last day for filing an annual tax return (financial data should be prepared within the period of 10 days from the day of approving the financial statements).</p> <p>Within the same term, the taxpayer is obliged to file its declaration on the preparation of TP documentation to the pertinent tax office.</p> <p>On the request of the tax authority, the taxpayer is obligated to prepare and present TP documentation covering a transaction or other event which is below the 'significant influence' threshold. In such case, the obligation should be fulfilled within the period of 30 days from the delivery of the request.</p>
€10 million	<p>The taxpayer is obligated to prepare a local file (as mentioned above) and benchmarking study.</p>	<p>Besides the above, the taxpayer is obliged to submit a simplified report on the transactions or other events with related parties (CIT-TP form) along with the tax return.</p>
€20 million	<p>The taxpayer is obligated to prepare a master file. The master file, besides the requirements of the local file and benchmarking study, should also include information on the group of related parties that the taxpayer is a part of, that is:</p> <ul style="list-style-type: none"> • an indication of the related party that prepared the information on the group, along with an indication of the date on which party files its tax return; • the organisational structure of the group; • a description of the transaction price policy the group applies; • a description of the subject and scope of business activities the group pursues; • a description of the significant intangible assets held, created, developed and used in the course of the group's business; • a description of the financial condition of the entities comprising the group, along with their consolidated statements; and • a description of the arrangements pertaining to income tax made by the entities comprising the group with tax administrations of countries other than Poland, including unilateral prior pricing arrangements. 	<p>As above.</p>
€750 million	<p>Besides the obligation to prepare the master file, a taxpayer has to file the CBCR with its tax office. The CBCR includes information on: the amount of income generated and tax paid; locations in which the capital group pursued their activities; and the location of the activities of their subsidiaries and foreign establishments that form part of the capital group during a given fiscal year.</p>	<p>Besides the above, the taxpayer is obliged to file the CBCR with the tax office within the period of 12 months following the end of the taxpayer's fiscal year.</p>

The TP documentation pertaining to transactions or other events carried over into the next fiscal year has to be periodically reviewed and updated at least once in every fiscal year, before the end of the period for the submission of the annual tax return. Furthermore, taxpayers are obliged to provide benchmarking studies of transactions or other events, and should

also update such studies at least once every three years, unless there is a change of economic conditions to the extent that has a significant impact on the analysis of comparative data which justifies conducting a review during the year in which such a change takes place.

III PRESENTING THE CASE

i Pricing methods

The conditions under which transactions or other events are performed between related parties should comply with the conditions agreed upon between independent entities, or conditions established by the party with an independent entity in comparable circumstances. Therefore, TP regulations⁶ indicate that all terms of transactions or other events between related parties should be presented in a comparability analysis (a benchmark or benchmarking study). It is an essential tool for both tax authorities (examining the terms of a transaction between related parties) and taxpayers (defending the method of transfer pricing applied). It also helps to evaluate whether the arm's-length principle is satisfied or not, as without it market prices would be hard to determine. It must be stated that TP regulations concerning the comparability analysis and its requirements bind only tax authorities, whose actions have to be evidenced and explicitly permitted by an act of law. Consequently, the comparability analysis presented by taxpayers may have a less restrictive form, as its main goal is to prove the given price is set at the market level. If the comparability analysis is effective in this matter, it cannot be questioned.

The analysis should take into account in particular: (1) the characteristics of goods, services or other benefits; (2) the course of the transaction (parties' functions, engaged assets, human capital and incurred risks); (3) the terms of the transaction; (4) the economic conditions present at the time and place the transaction is executed; and (5) an economic strategy. Taking all the features of the analysis into consideration, its aim is to identify not only the conditions of the transaction that would be set by independent entities, but also the most appropriate pricing method.

Regarding pricing methods, TP regulations define five pricing methods that may be used by tax authorities to verify whether the conditions of the transaction between related parties are consistent with market conditions, which are:

- a* the comparable uncontrolled price method – most often used in reference to typical products that can be publicly traded (i.e., by online exchange of agricultural products and goods);⁷
- b* the resale price method – most often used in the case of distributors, who are inclined to further market goods without improvements;⁸

6 The comparability analysis requirements were regulated specifically in the Regulation of the Minister of Finance of 10 September 2009 on the manner and procedure of determining legal persons' incomes by estimation and the method and procedure for eliminating the double taxation of legal persons re: adjustment of the profits of related parties, and the Regulation of the Minister of Finance of 10 September 2009 on the manner and procedure of determining natural persons' incomes by estimation and the method and procedure for eliminating the double taxation of natural persons re: adjustment of the profits of related parties.

7 Wójcik Zbigniew, 'Metoda porównywalnej ceny niekontrolowanej' in: Nykiel Włodzimierz, Strzelec Dariusz, 'Podmioty powiązane. Ceny transferowe. Dokumentacja podatkowa', LEX 2014.

8 Kosieradzki Tomasz, Piekarczyk Radosław, 'Ceny transferowe. Nowe zasady dokumentacji, Rozdział 6 Metoda ceny odsprzedaży', WK 2016.

- c* the reasonable margin method ('cost plus') – most often used in the case of manufacturers or service providers selling goods or services in a standardised and routine manner;⁹
- d* the distribution of profits method – most often used in the case of distribution business transactions;¹⁰ or
- e* the transactional net margin method.

The comparable uncontrolled price method, the resale price method and the cost plus method are indicated as basic models and are used initially. There is no hierarchy among them and they are treated as being equivalent to each other.¹¹ It must be mentioned that under previous TP regulations in force before 2013, the comparable uncontrolled price method had priority over others. However, this rule was repealed and the legislature underlined the freedom to select the TP method. When choosing the TP method, you should take into account which of the basic models appears to be the most effective. If none of them can be used, profit split methods may be applied.

ii Authority scrutiny and evidence gathering

In January 2016, representatives of the Polish government signed the Multilateral Competent Authority Agreement concerning the automatic exchange of information contained in CBCR forms. In parallel, the specific provisions on CBCR were also applied from 1 January 2016, imposing a tax obligation to submit information about the group within a period of 12 months following the end of the taxpayer's fiscal year. Although the first CBCR forms should be filed by the end of 2017, there are no clear guidelines as to the content and structure of the CBCR form to date. The regulation on this matter is still in the legislative phase. The draft presented by the Minister of Development and Finance is consistent with the forms recommended by the OECD in BEPS Action 13 – 2015 Final Report.¹² Moreover, the Act of 9 March 2017 on Tax Information Exchange with Other Countries introduced the exchange of tax information concerning, for example, the automatic exchange of information on advance pricing arrangements (APAs), tax rulings and CBCRs. Thanks to those regulations, Polish tax authorities have gained new tools to gather information and evidence about taxpayers and their related entities. Consequently, one may predict that the international and global tax position standard and the profit share per jurisdiction assessment will be standard in the future.

9 Kosieradzki Tomasz, Piekarczyk Radosław, 'Ceny transferowe. Nowe zasady dokumentacji, Rozdział 5 Metoda rozsądnej marży (koszt plus)', WK 2016.

10 Wójcik Zbigniew, 'Metoda marży transakcyjnej netto' in: Nykiel Włodzimierz, Strzelec Dariusz, 'Podmioty powiązane. Ceny transferowe. Dokumentacja podatkowa', LEX 2014.

11 Judgment of the Administrative Court in Wrocław dated 14 January 2011, case no. I SA/Wr 1253/10.

12 See: The draft Regulation of the Minister of Development and Finance on the detailed scope of data transferred information about a group of entities that will be passed in the CBC report dated 24 October 2016, in Polish: 'Rozporządzenie Ministra Rozwoju i Finansów w sprawie szczegółowego zakresu danych przekazywanych w informacji o grupie podmiotów'. The draft of regulation was published at: <http://legislacja.rcl.gov.pl/docs/2/12285652/12354106/12354107/dokument253090.PDF>.

IV INTANGIBLE ASSETS

Polish TP regulations do not define intangible assets. However, the concept of intangible assets is raised on the occasion of the depreciation regulations under the CIT and PIT Acts and is defined as copyright or related property rights, licences, and rights referred to in the Industrial Property Law and 'know-how'. The definition of intangible assets should nevertheless be defined more widely for TP purposes because it covers not only transactions but also other events between related parties. When it comes to general approaches to dealing with intangible assets, TP regulations do not provide any specific regulations in this matter, and in particular do not impose an obligation on a taxpayer to show where the substance developing, supporting or exploiting the intangible asset is based to justify a higher than passive return. When it comes to pricing and cost distribution methods, the general rules described in Section III, *supra*, are applied. The only distinction for intangible assets provided in TP regulations concerns the examination and questioning of used prices and cost distribution between related parties from the tax authorities' perspective.

With regard to the above, tax authorities examine intangible assets transactions or other events as to whether independent entities acting reasonably would have concluded the transaction or other event on the terms and conditions as agreed between the related parties. In cases where the reasonably expected benefits to the party are obviously lower than the expenses incurred in connection with this transaction or event, the party should indicate the rational reasons for this. When the party does not present a rationale, the tax authorities examine the correctness of the amount of incurred expenses, including also the costs conditioning the use of a given intangible asset.

In the case of a taxpayer's participation in the costs jointly incurred by related parties to create an intangible asset, the amounts paid by the taxpayer can be regarded as compatible with the arm's-length principle only when such terms and conditions could have been agreed between independent parties. In particular, conditions of the transaction or other event should be proportional to the expected benefits and burdens of the parties. Also, the benefits that were not expected (included) when determining those conditions should be proportionally distributed. Moreover, TP regulations order a party to accept lower cost values in the situation where the taxpayer had the opportunity to obtain comparable benefits under the agreement with a related party or from an independent entity, when in one of these cases lower costs would be incurred.

V SETTLEMENTS

APAs were introduced into the Polish tax system from 1 January 2006 and are regulated in the Tax Ordinance Act. Polish APAs were not applied to be fully in line with OECD guidelines. In contrast to OECD solutions, Polish APAs cannot be treated as an agreement concluded between a taxpayer and tax authority. Procedurally, a solution implemented into the Polish tax system is a decision issued by the competent authority overseeing tax administration – the head of the National Fiscal Administration (NFA) – and for this reason, it constitutes a unilateral and domineering act of an administrative case settlement. The APA decision may then declare or not: (1) the comparability of material conditions determined between related parties with the conditions that would have been determined by independent entities, and the correctness of the used pricing method choice; or (2) the comparability of material conditions determined in a cost distribution agreement concluded between related parties with the conditions that would have been determined by independent entities. For

a taxpayer, APAs are a tool to reduce the risk of the tax authorities challenging pricing or cost distribution than a tool to jointly develop terms of pricing or cost split between related parties.

The procedure to issue an APA decision starts with a domestic entity's request, indicating: the proposal of pricing or cost distribution methodology; reasoning for this method; and necessary materials and documents including a complex economic and financial analysis of the transaction and proposal regarding the decision's validity period. The scope of the request cannot concern transactions completed before the date of the submission of the request or transactions started before such date that are already subject to tax audits before the tax authorities or administrative courts. Therefore, the APA decision mainly covers future transactions.

The Polish Tax Ordinance Act distinguishes three categories of APA decisions: one-sided, bilateral, and multilateral. One-sided APA proceedings are carried out by Polish tax authorities. The bilateral APA decision is in turn concluded between domestic and foreign entities and requires the approval from a tax authority of the given foreign country. If an arrangement concerns entities from more than one foreign country, the approval of each foreign tax authority is necessary to be able to conclude such multilateral APA decision. It must be emphasised that only APAs concerning pricing may be bilateral or multilateral, as the Tax Ordinance Act does not provide such possibility when it comes to cost split agreements.

The proceedings to issue the APA decision do not differ much from a typical tax audit: the applicant has to fulfil formal requirements, is entitled to submit additional clarifications and documents and even change the proposed pricing method (by the time the decision is issued) or withdraw the request. According to the Tax Ordinance Act, the APA proceedings should be completed without undue delay. The maximum limitation periods for case settlement are six months for a one-sided decision, a year for a bilateral decision, and 18 months for multilaterals. Yet, those terms are considered as procedural time limits and their expiry does not deprive the tax authority of the ability to issue a decision.

The Tax Ordinance Act imposes obligations on tax authorities to notify the applicant when the proposed pricing method is contrary to the conditions that would be agreed upon by independent entities. Such notification contains a factual and legal substantiation and gives the applicant the possibility to amend its proposal, submit additional clarifications or even withdraw the APA request within 30 days from being filed. Similarly, in the case of bilateral and multilateral APA decisions, when the tax authority competent for a foreign entity does not consent to the conclusion of an arrangement or if it may be reasonably expected that such consent will not be granted within six months from the day it is applied for, the tax authority has to notify the applicant about such fact. Consequently, within 30 days from the delivery of the notice, the applicant may: withdraw the application for the APA decision; change its application from bilateral to unilateral; or change its application from a being multilateral to being bilateral.

The APA decision may be issued for no longer than five years, which period may be renewed for subsequent periods, not longer than five years, upon the request of a domestic entity filed no later than six months before the lapse of the previous period of validity. The renewal, which is also proceeded in a form of the decision, is possible if the elements of the decision did not change in any significant manner. Such renewed APA decision enters into force as of the day following the day on which the validity period of the previous decision has elapsed.

The APA decision may be amended or declared as expired before the end of its validity period only in the case of a change of economic relations which results in the agreed terms of

transaction being grossly inadequate. The procedure for this matter may be initiated by the party itself or *ex officio*. It must be stated that the term ‘change of economic relations’ was not explained in more detail. However, one may assume that the term should be interpreted as a situation significantly different and extraordinary from that in which the APA decision was issued (e.g., hyperinflation or a significant change in exchange rates).¹³ Amendments or the declaration of the expiry of the APA decision are in the form of a decision that enters in force from the day of its delivery to the party.

The APA decision may be also declared as expired *ex officio* by the NFA when the related parties do not apply the transaction price or cost distribution determination method or the conditions defined in the decision. Such declaration of the APAs expiry is also in the form of a decision, which enters into force from the day it is delivered.

Regardless of the fact of having an APA decision, related entities are not exempted from the obligation to prepare TP documentation for the transaction. However, the formal requirements are limited. The TP documentation for a transaction confirmed with an APA decision must therefore consist of its financial data, description and the indication and explanation of pricing or cost distribution method used.

There is a lot of criticism regarding APAs functioning in Poland. First of all, they are considered as an inadequate yet expensive tool, taking into account statutory fees (up to 200,000 zlotys), but also all additional costs such as benchmarks, legal and advisory support costs. Secondly, the administrative procedure is also far from the flexible atmosphere of negotiations that entities commonly expect. Moreover, the length of the process, which in some cases may last as long as a year, does not meet the reality of a fast-changing business and economic world. Finally, the scant popularity of APAs (see the tables below¹⁴) results also from the fact that Polish taxpayers are not willing to disclose all aspects of a planned transaction to tax authorities when they do not have to.

Concluded APAs			
Year	One-sided APAs	Bilateral APAs	Multilateral APAs
2006	1	0	0
2007	2	0	0
2008	6	0	0
2009	2	0	0
2010	7	0	0
2011	2	2	0
2012	5	0	0
2013	4	0	0
2014	0	0	1
2015	5	1	0
2016	5	1	0
APA proceedings in progress			
	6	13	1

13 Dowgier Rafal, ‘Commentary on Article 20(k) of the Tax Ordinance Act’ in: Brolik Jacek and others, ‘Ordynacja podatkowa. Komentarz’, LEX 2013.

14 Statistics dated 21 February 2017 presenting already concluded APAs and those that are still in progress, www.finance.mf.gov.pl/cit/ceny-transferowe1/upzednie-porozumienia-cenowe-apa/statystyki-apa.

VI INVESTIGATIONS

Tax authorities are entitled to investigate taxpayers to assess whether transactions or other events between related parties were performed in accordance with TP regulations. Therefore, the subject of the TP investigation usually concerns:

- a* CIT or PIT grounds – whether the related parties have set the transaction's conditions differently than independent entities would agree on; or
- b* VAT grounds – whether the remuneration for goods or services set by related parties (a customer and a person supplying the goods or the supplier itself) was at the market value level.

The TP investigation may then state that the pricing of the transaction or other event between related parties was in line with conditions that would be set by independent parties or it may indicate some irregularities arising from the relationship between the parties. In the second case, the tax authorities have the right to determine the taxpayer's taxable amount and tax due (see more in Section VIII, *infra*).

It is important to note that the investigation may be initiated if the taxpayer's tax liability expires. As a rule, the limitation period is five years beginning at the end of the calendar year in which the time limit to pay tax ended. That means that as a result of the flow of time, the tax liability expires by law and the tax authority cannot effectively demand payment of the due tax, as in fact it no longer exists. Nevertheless, the Polish tax system provides a catalogue of numerous circumstances that may suspend or interrupt the limitation period. The most common reasons to suspend the limitation period are: the application of an enforcement measure of which a taxpayer was notified; the commencement of proceedings in a case involving a fiscal crime or fiscal offence of which the taxpayer has been notified; or if a complaint against a decision concerning that liability is filed with an administrative court. Moreover, the limitation period is also interrupted with the taxpayer's declaration of bankruptcy.

There are three types of tax investigation that may consider transactions or other events between related parties: a tax audit; tax proceedings; and a customs and fiscal audit. The choice of tax investigation depends mostly on whether a taxpayer to investigate has been chosen and what kind of tax authority is going to perform such investigation.

i Tax audit

A tax audit starts with a notification being sent to the taxpayer that a tax audit is to be conducted. The tax audit is initiated no earlier than seven days and no later than 30 days from the delivery of such notice. In certain circumstances, a tax audit may be conducted without giving prior notification (e.g., a fiscal or commerce offence is committed).

The tax audit must be conducted within the period indicated in the authorisation (i.e., the document authorising the tax authority to initiate a tax audit), and during a single calendar year cannot exceed 28 business days. The limitation periods are established in the Business Freedom Act and depend on the taxpayer's qualifications as a micro, small, medium-sized or large entrepreneur.

The tax audit ends with the delivery of the tax authority's protocol. Such protocol consists of a description of the facts of the case and a legal assessment, but it does not constitute the taxpayer's liability. If the tax audit indicates some irregularities, after the delivery of the protocol, the taxpayer may: (1) agree with the tax authority and correct its tax settlements and tax return; or (2) make reservations and clarifications to the protocol within 14 days after its

delivery. The tax authority is then obliged to review them within the next 14 days. A tax audit that has ended with a dispute between the tax authority and the taxpayer usually continues in the form of tax proceedings.

ii Tax proceedings

The main aim of tax proceedings is to settle the case by issuing a pertinent decision. To issue the pertinent decision, the tax authority will establish the case facts, collect evidence and make the most appropriate tax assessment. In most cases, tax proceedings are initiated by the tax authority when the tax audit reveals taxpayer irregularities. Although it is unusual, tax proceedings may be initiated upon a taxpayer's application as well.

Tax proceedings should be settled without undue delay. When requiring evidentiary hearings, limits are longer and are set as a month, or in particularly complicated cases, two months from the day proceedings began. In practice, those limits are not kept and tax authorities extend them due to case complexity.

Tax proceedings are a two-instance procedure. The first ends with a decision which may be subject to the taxpayer's appeal. The taxpayer's appeal must be submitted within 14 days counting from the date of the delivery of the decision. In such case, the upper instance examines the whole case anew and settles the case with a further decision. Appellate proceedings should be settled at the latest within two months from the submission to appeal, and in cases where a trial was conducted at the latest within three months. The above-mentioned time limits are often extended by tax authorities.

The decision of the upper instance is final and enforceable. However, such decision still may be challenged by lodging a complaint to the voivodship administrative court (see more in Section VII, *infra*).

iii Customs and fiscal audit

The customs and fiscal audit was introduced into the Polish tax system from 1 March 2017 and it replaced the fiscal audit procedure. Tax authorities that may initiate such investigation are customs and fiscal offices. The audit is initiated only *ex officio* on the basis of authorisation to carry it out. To resolve the matter that led to the authorisation being issued, the taxpayer may correct its tax returns within 14 days of receiving the authorisation. After that date, corrections made before the end of the customs and fiscal audit have no legal effect.

Customs and fiscal audit cases should be settled without undue delay, but not later than within three months of being started. Similarly to other investigation procedures, tax authorities may also in this case extend the period of the investigation.

The customs and fiscal audit ends with the delivery of the audit's findings. Similarly to the tax audit, the taxpayer has right to correct its tax settlements and tax returns within 14 days of the audit's delivery. If irregularities were indicated during the audit and the taxpayer did not correct its tax settlements and tax returns, the audit investigation transforms into tax proceedings. Such tax proceedings are continued by customs and fiscal offices in line with the scheme described in subsection ii, *supra*.

VII LITIGATION

i Procedure

TP cases may be the subject of a dispute before administrative courts only when the taxpayer lodges a complaint against the tax authority's decision. The complaint must fulfil formal

requirements (e.g., be submitted within 30 days of the delivery of the decision via the tax authority that issued the decision). When a complaint is lodged, the administrative authority is under an obligation to turn it over to the court with the relevant files and to prepare a response within a period of 30 days from the date it is submitted. It must be emphasised that the complaint is not particularly formalised since it only has to meet the requirements of a letter in a court proceeding.

In examining the tax authority's decision, the court's main task is to check whether the decision was taken in accordance with the law, both in terms of substantive and procedural provisions. Although the court rules within the limits of the case, it is not bound by the claims or statements made in the complaint or the legal grounds raised by the party (i.e., a taxpayer or a tax authority). Consequently, the court independently assesses the correctness of the decision. What is important is that the procedure before the administrative courts does not provide extensive evidentiary proceedings. Although the regulations of the Law on proceedings before administrative courts¹⁵ allow evidence to be taken from documents, in practice courts reject parties' applications to submit evidence.

The administrative courts may dismiss the complaint, overturn a decision fully or partially, or be confirmed invalid fully or partially.

The administrative court's decision may be appealed to the Supreme Administrative Court, whose judgment is final. A cassation appeal is lodged via the court that issued the judgment, within 30 days from the date of judgment and its delivery of its justification. The cassation appeal may only be based on strictly defined grounds, namely (1) the violation of substantial law – due to an erroneous interpretation or incorrect application of law, or (2) the breach of procedural regulations if that infringement could have seriously affected the outcome of a particular case. It is also more formalised than a complaint to the administrative court (e.g., the cassation appeal has to be prepared and submitted by professional proxy (advocate, attorney at law or tax adviser)).

As a rule, a case before the administrative court should be completed as soon as possible. However, the reality is slightly different as the waiting time for the first hearing takes up to 18 months.¹⁶ A taxpayer lodging a complaint at the voivodship administrative court in Warsaw or Cracow will likely wait for approximately one year before the case is considered. A backlog of cases in the Supreme Administrative Court (as it is the only upper administrative court in Poland) causes long delays in obtaining a hearing date, up to 18 months.¹⁷

ii Recent cases

As of 1 January 2017, TP regulations have significantly changed and consequently they will be applied to transactions or other events that occur or have occurred during the 2017 tax year. For this reason, new regulations will be subject to juridical interpretation starting from 2018. Nevertheless, the recent judgments may continue to be relevant.

15 Act of 30 August 2002.

16 Sławomir Łuczak, Karolina Gotfryd, *The Tax Disputes and Litigation Review*, Fifth Edition (Law Business Research), Poland, Section III.

17 Ibidem.

The TP documentation obligation

Judgment of the Supreme Administrative Court, Ref. No. II FSK 4000/13, 8 March 2016

The case regarded the obligation to prepare TP documentation for transactions between related treasury companies. The transactions concerned shares and stocks contributions to the related company. The Supreme Administrative Court stated that the TP regulations and resulting taxpayer's obligations also apply to transactions involving the transfer of goods, money and other things of value. Whether an economic operation triggers any income tax to be paid does not matter. Therefore, TP documentation is also required in the case of tax-neutral transactions.

Judgment of the Supreme Administrative Court, Ref. No. II FSK 2121/10, 27 April 2012

The case regarded the consequences of not fulfilling the taxpayer's obligation to prepare TP documentation. The Supreme Administrative Court ruled that such infringement does not automatically exclude the taxpayer's right to deduct expenses from an undocumented transaction. According to the judgment, only when the transaction price is contrary to its market value is it possible to use the exclusion from tax-deductible costs.

TP estimation

Judgment of the Voivodship Administrative Court in Warsaw, Ref. No. III SA/Wa 2017/14, 23 April 2015

The case concerned a taxpayer that provided subcontracting services on behalf of a related foreign company. The taxpayer also incurred licence fees under an agreement with that related foreign company in connection with subcontracted services. The licence fees were listed among deductible expenses. The tax authorities questioned the possibility to deduct those expenses and the Court agreed with the tax authorities' understanding. According to the judgment, the taxpayer did not bear any risks associated with the implementation of orders for its services. The licence fees also do not affect the number of received orders for a taxpayer's services. In conclusion, the Court stated that a taxpayer's licence fees could not have been classified as tax-deductible expenses as there is no relation between the taxpayer's income and expense. In addition, the Court noted that the agreement introducing licence fees between the taxpayer and the related foreign company was concluded four years after the concerned period; therefore evidencing that the described activities were meant to be an income transfer from the taxpayer to a related entity. This judgment was an example of in-depth analysis of a transaction from the perspective of economic rationality and business, and this line of reasoning will probably be continued in future cases.

Judgment of the Supreme Administrative Court, Ref. No. II FSK 2364/11, 20 July 2013

The case regarded the possibility to estimate the taxpayer's income resulting from transactions between related parties. According to the judgment, the mere existence of a capital relationship between the parties is not sufficient to estimate the amount of tax due from the taxpayer. It is important to examine whether, as a result of links between parties, there were established or imposed conditions that differed from those that would be made between independent entities. Moreover, tax authorities may estimate the income derived from a transaction with a related party only when the taxpayer does not claim income at all, or claims a lower than expected amount without such relationship between parties. Then, the taxpayer's due income tax should be determined as if it were between independent parties.

Judgment of the Voivodship Administrative Court in Wrocław, Ref. No. I SA/Wr 1107/11, 24 November 2011

The case regarded the tax authorities' contestation of a property's selling price on which the construction of a shopping mall started. Tax authorities had estimated the market value of the transaction based on data from only one comparable transaction. The Court stated that a single observation is not sufficient since it is hard to accept in advance that one transaction between independent entities reflects a typical example of such transactions and can form the basis to determine the market value of the sold property.

VIII SECONDARY ADJUSTMENT AND PENALTIES

i Tax penalties

Income corrections

When performing an investigation (see Section VI, *supra*), tax authorities are entitled to examine whether related parties have set a transaction's conditions differently from those that independent entities would agree upon. In particular, they identify comparable transactions or events and choose the best method to determine their market value. If tax authorities state that the terms and conditions of transaction or other event between related parties differ from those between independent entities, they determine the taxpayer's income and the income tax due. Income tax at a rate of 19 per cent is charged on the difference between the income declared by the taxpayer and specified by the tax authorities.

50 per cent income tax rate

Tax authorities have the right to require the taxpayer to provide them with TP documentation. In such case, the taxpayer should present the TP documentation within seven days of delivery of the request. Where the taxpayer does not submit the TP documentation on time, the tax authorities can levy a sanction tax rate of 50 per cent. The conditions to impose such penalty are: (1) the taxpayer failing to provide TP documentation, and (2) tax authorities determining the taxpayer's income amount from the TP transaction or other event as higher (or taxpayer's loss amount lower) than the amount the taxpayer declared by itself.

It should be noted that the failure to file TP documentation does not automatically mean the application of the 50 per cent tax rate is possible. The sanction tax rate may be applied only when the transaction or other event between related parties was set contrary to its market value.

The sanction rate is applied in the form of a decision, which has a constitutive character. Therefore, as legal doctrine¹⁸ indicates, it cannot be imposed on the taxpayer if the decision fixing the amount of the tax liability was delivered to the taxpayer after three years from the end of the calendar year in which the tax liability arose.

VAT obligations correction

The tax authorities are also entitled to question transactions between related parties if that relationship had an impact on the value of goods or services and remuneration for the

18 Kosieradzki Tomasz, Piekarczyk Radosław, 'Ceny transferowe, Mechanizmy ustalania i zarządzanie ryzykiem, Rozdział 18. Sankcje w zakresie cen transferowych'.

transaction. In consequence, tax authorities have the right to determine the VAT taxable amount and VAT due taking into account the remuneration of goods or services that are not in line with their market value, for example, in situations:

- a* when the remuneration was lower than the market value and a customer of the goods or services did not enjoy a full right to reduce the input VAT;
- b* when remuneration was lower than the market value and a person supplying goods or services did not enjoy a full right to reduce the input tax amount, and a supply of goods or services was exempt from VAT; or
- c* when remuneration was higher than the market value and a person supplying goods or services did not enjoy a full right to reduce input VAT.

Having mentioned the above, the tax authorities have the right to increase or decrease the tax base for VAT purposes to the transaction's market-value level.

Interest on tax arrears

As a consequence of redetermining the due VAT or CIT or PIT, the taxpayer has tax arrears. Further, the taxpayer also has to pay penalty interest. The interest rate for tax arrears incurred from 1 January 2017 is 8 per cent. It must also be underlined that the interest rate may be applied at a higher 12 per cent rate when VAT arrears have their source via understating a tax liability, or overstating a tax overpayment or a refund amount that was subsequently discovered by the tax authority during a tax investigation.

ii Fiscal penal liability

If a taxpayer fails to comply with tax obligations, it may result in fiscal penal liability. According to the Fiscal Penal Code,¹⁹ only individuals may bear fiscal penal liability even if a tax obligation is imposed on a legal entity. Therefore, the liability for fiscal offences rests with an individual who, under the provisions of law, a decision of the relevant authority, an agreement or actual execution, conducts the economic, and in particular financial, affairs of the legal person. Furthermore, a fiscal offence is committed only by an individual to whom guilt may be attributed in the course of an act; however, this does include the awareness of the misconduct along with acceptance thereof. From this perspective, the risk of fiscal penal liability rests in particular with the management board's members and finance or tax director. Non-compliance with TP regulations may cover several criminal acts, for example, failure to disclose the object of taxation or tax base, tax fraud, obstruction of a tax audit or a customs and fiscal audit, and accounting procedure infringements.

Committing a fiscal criminal act may result in the imposition of a pecuniary fine or even imprisonment. In practice, imprisonment is rather theoretical and it refers to very serious economic crimes; however, criminal courts very often hand out pecuniary fines. The pecuniary fine may be up to 720 daily rates. In 2017, one rate may vary between 66.67 and 26,666.66 zlotys. Therefore, the potential maximum fine may be over 19 million zlotys (again, in practice the criminal courts adjudicate much lower fines).

19 Act dated 10 September 1999.

IX BROADER TAXATION ISSUES

i Double taxation

All double taxation treaties (DTT) concluded by Poland provide the possibility to evoke the Mutual Agreements Procedure (MAP). MAP has been implemented into Polish domestic law in the Minister of Finance's Regulations.²⁰

According to those rules, a person may present its case to the Minister of Finance to start the MAP under the Convention of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises or on the basis of a DTT with Poland. The MAP procedure may be used when formal requirements are met and within the limit of a three-year term. This term is counted from the date of the delivery to the taxpayer or its related party of the tax audit protocol or tax decision which leads or may lead to double taxation. Polish regulations provide that the MAP is required to be finalised within two years. Moreover, there is also the possibility of a trilateral MAP. The MAP cannot be used as a premise to suspend an ongoing tax proceeding. However, when the MAP has been successfully finalised, it may constitute a premise to revision.

ii Consequential impact

VAT

Please see Sections I.ii and VIII.i, 'VAT obligations correction', *supra*.

Import and customs duties

The customs aspect of TP remains unnoticed – at least in Poland – both by doctrine and the customs and tax authorities. However, there are binding customs system regulations covering TP (e.g., the Union Customs Code, which defines the obligations and duties in this matter).

X OUTLOOK AND CONCLUSIONS

Since 2015, the main policy of the current Minister of Finance is to 'seal the tax system'. New tools and tax obligations have been introduced to fulfil this goal. One of such tools is the extension of TP obligations and their effective enforcement by tax authorities. The number of tax investigations in this matter has increased in recent years; for example, in mid-2016, a total of 222 investigations were launched.²¹ The investigations are not only performed more frequently but also are more likely to end with tax liabilities being imposed. We believe that this trend will continue in 2017 and the following years, reaching the levels seen on an international basis.

20 Ibidem, 5.

21 <https://home.kpmg.com/pl/pl/home/insights/2016/08/tp-alert-wzrost-skuteczności-kontroli-skarbowych-w-i-polowie-2016-r.html>.

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