



A&RT Report

Transfer pricing

Tax risks and tax controls



A&RT



A&RT Rynkowska, Kosieradzki, Piekarz SKA

www.cenytransferowe.biz

List of Contents

| | |
|--|----|
| Introduction | 3 |
| The report's summary..... | 4 |
| Interpretations and advance pricing agreements | 5 |
| Transfer pricing controls..... | 7 |
| Poland in comparison to other countries | 9 |
| The authors..... | 11 |



Introduction

Transfer pricing regulations are present in Poland since the year 1997.

Additionally, in 2013 the Ministry of Finance conducted a significant amendment to the implementing regulations for transfer pricing. What ought to be positively assessed are the regulations on the documentation services low value added value, as well as the procedures of the comparability of the transactions. A definite drawback is however, completely unclear regulations concerning the so-called business restructuring.

It is worth remembering, that the last year transactions between related parties are one of the control priorities of the tax authorities.

Having taken that into consideration, it can be ostensibly concluded, that the subject of transfer pricing is a subject well-known and understood among Polish companies and tax authorities. The legal firm A&RT Rynkowska, Kosieradzki, Piekarz decided to investigate the practical application of transfer pricing regulations by both businesses and tax authorities. Moreover, we have compared the administrative burdens on business activities in Poland and abroad.

The methodology used to create the report

a) The responses of the Ministry of Finance

On the December 8 2013, the A&RT issued a request for public information to the Ministry of Finance. In response to this request, on December 24 2013, the Ministry of Finance provided answers to our questions. Unfortunately, the Ministry does not yet have any data in regard to the year 2013.

b) OECD's Databases

The responses of the Ministry of Finance have been complemented with OECD data, in particular with regard to the so-called mutual agreement procedures and other statistical studies.

You are welcome to read.

Radosław Piekarz, partner in A&RT

Tomasz Kosieradzki, partner in A&RT

The report's summary

Below, we present a brief summary of the report; the summary is divided into two parts: facts and the postulated changes in regard to these regulations.

Facts

| | |
|------------------|--|
| about 100 | The number of employees hired in the fiscal authority (UKS) responsible for inspections in the field of transfer pricing |
| 923 | The total number of inspections in the field of transfer pricing in 2009-2012 |
| 843 M PLN | The total amount of additional valuation of income by UKS in 2009-2012 |
| 913 K PLN | The total amount of additional valuation of income by UKS in 2009-2012 |

Postulated changes in regard to the regulations

- A change of thresholds obliging to prepare documentation— thresholds of 30 000 EUR and 50 000 EUR were determined in 2001. The thresholds have never been valorised and as a result they are too low.
- A change of the threshold of the share capital— the threshold of 5% is the lowest in Europe.
- To simplify the documentation for small and medium-sized enterprises (taking example from documenting services with a low added value).
- To specify the rules for the calculation of thresholds documentation – currently it is disputable for e.g. if in case of a loan the whole amount (fund and interest) should be taken into consideration or just the interest (as the value having an impact on the tax liability).
- A change in the conditions and procedures for obtaining Advance Pricing Agreements – the present system is inefficient.

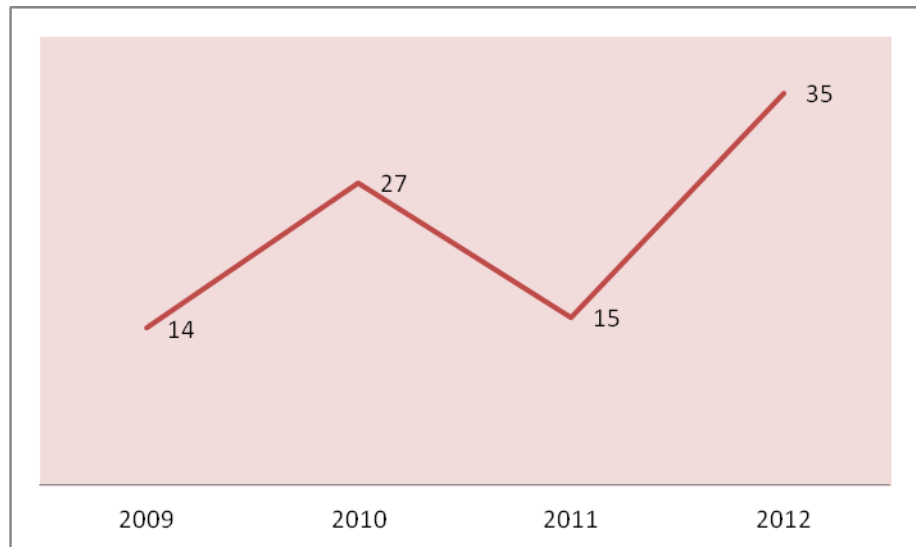
Interpretations and advance pricing agreements

In accordance with the regulations of tax law, businesses may apply for an individual interpretation of tax law. However, this tool is of limited use in terms of transfer pricing because in the framework of interpretation the Minister of Finance does not confirm the accuracy of the transfer pricing methodology nor their amount. These issues may be, nonetheless, the subject of the so-called: advance pricing agreement issues through the negotiations procedure by the Minister of Finance.

Tax interpretations

In 2009-2012, the Minister of Finance issued just 91 individual interpretations relating to transfer pricing. Most of these interpretations were regarding the obligation to prepare transfer pricing documentation in specific cases (eg. for cash pooling agreements).

Picture 1: The number interpretations issued by the Ministry of Finance in regard transfer pricing.



Source: own analysis based on: www.sip.mf.gov.pl

Advance pricing agreements

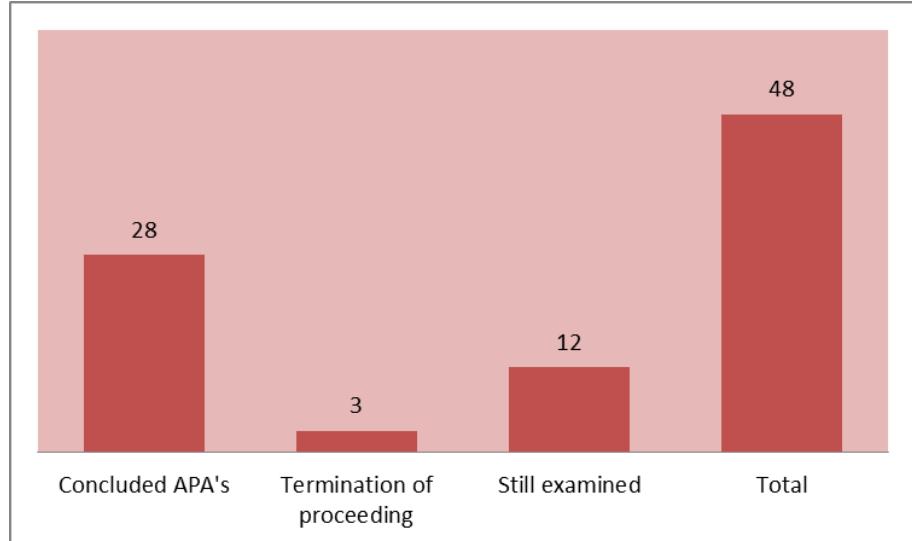
The second tool available to taxpayers relating to transfer pricing are the so-called: [advance pricing agreements]. Since the introduction of this institution the Minister of Finance has concluded only 28 advance pricing agreements.

The main limitation to this procedure is the price, which needs to be paid for issuing the agreement and the fact that the entrepreneur interested in receiving such an agreement is required to disclose confidential information

regarding the price fixing, agreements between counterparties, discount policy, the cost of production, etc.

Additionally what is important, the conclusion of the agreement is a time-consuming procedure. The duration of the procedure lasts on average 17 months. Less time on the other hand takes an extension of the deadline of the agreement. This procedure takes three months.

Picture 2: The statistic of requests for advance pricing agreement as of 24 December 2013.



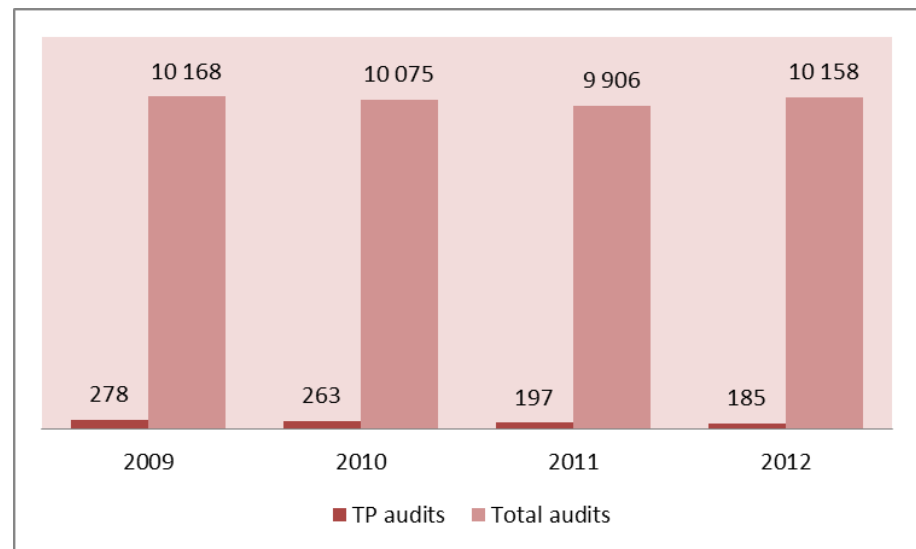
Source: own analysis based on the Ministry of Finance's data

The above data show that the system of advance pricing agreements is ineffective. The number of applications submitted, indicates that taxpayers are not interested in such an agreement, since - as shown in the further part the report - the possible threat of control is unlikely.

Transfer pricing controls

The Ministry of Finance does not have information on the number of controls on transfer pricing conducted by the tax authorities (local authorities). On the other hand, the Ministry has information on the controls conducted by the fiscal inspection (16 offices in Poland). In the years 2009-2012, there has been conducted respectively 278, 263, 197 and 185 fiscal controls on transfer pricing, which represents approximately 3% of all audits.

Picture 3: The number tax inspections in general and transfer pricing in 2009-2012



Source: own analysis based on the Ministry of Finance's data

During tax inspections on transfer pricing the total additional revenue was estimated in the amount of:

- for the year 2009 - 323 385 000 PLN
- for the year 2010 – 158 219 000 PLN
- for the year 2011 – 190 471 000 PLN
- for the year 2012 – 171 461 000 PLN

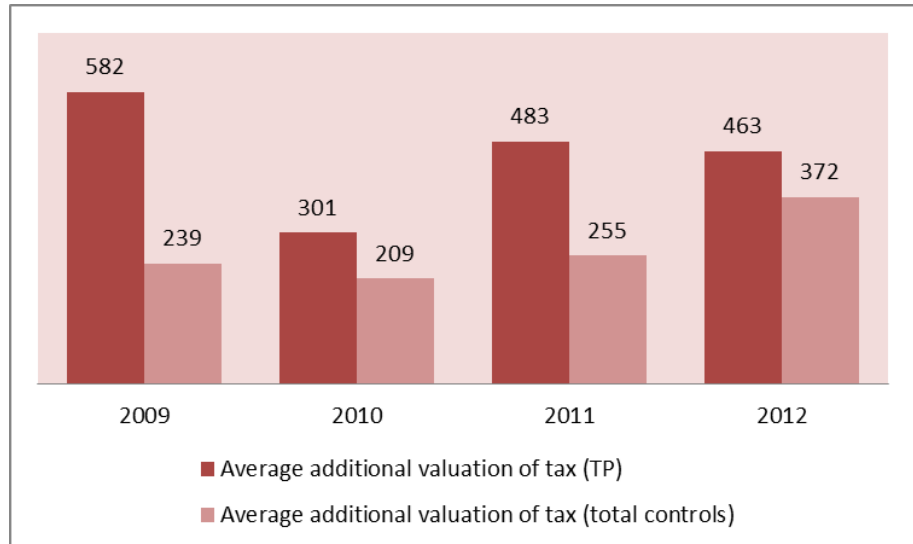
The average amount of the additional valuation in the following years was:

- for the year 2009 – 1 163 000 PLN
- for the year 2010 – 602 000 PLN
- for the year 2011 - 967 000 PLN
- for the year 2012 - 926 000 PLN

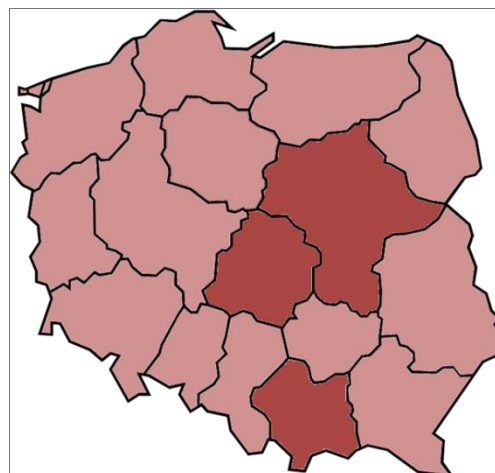
From such additional valuation of income a tax is charged at the rate of 50% when taxpayer does not have transfer pricing documentation or 19% when such documentation has been prepared by the taxpayer.

It is worth noting that controls on transfer pricing, although rare, can be very expensive for the taxpayer. The amount of additional valuation of tax (at the rate of 50%) during the control of transfer pricing is in the years 2009 and 2011, twice as high as the additional tax valuation during the other controls.

Picture 3: Average additional tax estimation during the tax controls in years 2009-2012



Source: own analysis based on the Ministry of Finance's data



There is a lot of interesting information on the number of employees of the tax authorities involved in the inspections on transfer pricing. In Poland there is about 100 inspectors of such kind. Most of them work in the Mazowieckie, Łódzkie and Małopolskie voivodeship.

Picture 5: Specialists in transfer pricing in the tax authorities.

Poland in comparison to other countries

Thresholds for capital ties

The key aspect of transfer pricing is the definition of related parties. Most often these entities are defined by determining a specific threshold of shared capital, exceeding which indicates that we are dealing with related parties.

In Poland this threshold is 5% and is one of the lowest in the Europe.

Table 1: Thresholds for capital ties

| Country | Tie threshold |
|----------|---------------|
| Poland | 5% |
| Slovenia | 25% |
| Japan | 25% |
| Norway | 50% |
| Portugal | 10% |
| Russia | 20% |

Simplifications

In 2010, OECD has published a report „Multi-country analysis of existing transfer pricing simplification measures”, in which the simplifications regarding tax documentation in particular member-countries of OECD have been described.. In the reports the Polish remarked that in the field of simplifications there is one mechanism, i.e. lack of documentation obligation for low turnover with related parties. To remind, these threshold are:

- 30.000 EUR for intangible transactions (service transactions, connected to transfer of ownership of an intangible and legal asset, etc.)
- 50.000 EUR for tangible assets (e.g. sale of goods),
- 100.000 EUR for intangible assets, if their value does not exceed 20% of the seed capital.

What is worth adding is that the objective thresholds are not valorised by the inflation rate and they were introduced to the CIT Act in 2001. In consequence, their practical implementation – in principle – does not take place since the related parties exceed the thresholds in the first moth of the tax year.

In this context, it is worth learning which simplifications are used by other countries.

Tabel 2. Simplifications in documenting the transactions

| Country | Type of simplification |
|-----------------------|--|
| Germany | Turnover limit: 5.000.000 EUR for transactions of goods, 500.000 EUR for transactions of services. |
| Ireland | Only for small and medium enterprises. |
| Czech Republic | None (but there is a lack of documentation obligation) |
| Denmark | Lack of documentation obligation for intangible transactions regarding scale and frequency. Lack of documentation obligation for small and medium enterprises. |
| Estonia | Lack of documentation obligation for companies, which: - hire less than 250 persons, - had a turnover lower than 50 million EUR per year, - had total asset lower than 43 million. Those values sum up with the related parties. |
| Finland | Lack of documentation obligation for small and medium enterprises. Simplified documentation for related parties once the yearly turnover is lower than 500.000 EUR per year. |

The authors



Radosław Piekarczyk, Partner, Tax advisor

A graduate of both Faculty of Economy and Faculty of Management at the University of Warsaw. Radek has a 9-year-long experience in tax advising gained while working in one of the leading international consulting companies. His specialty is transfer pricing. What is more, he specializes in preparing comparative and statistical analyses and VAT tax.

He is an author of academic articles on VAT, duty and is the co-author of the book "Fiscal aspects of business activity in special economic zones" (pub. Unimex 2012).

Registration No.: 11206

mobile: 691 016 305

e-mail: rpiekarczyk@a-rt.pl



Tomasz Kosieradzki, Partner, Tax advisor

Lawyer, tax advisor – registration number 10797. A graduate of Faculty of Law and Administration at the University of Warsaw. He has been taking care of tax advisory for the last 8 years.

Main areas of his professional experience include: advisory in terms of tax optimisation, international tax law, transfer pricing.

Moreover, Tomek is engaged in carrying out complex and problematic tax audits.

Registration No.: 10797

mobile: 608 588 511

e-mail: tkosieradzki@a-rt.pl

Kancelaria A&RT Rynkowska, Kosieradzki, Piekarz

If taken into consideration that over 60% of international trade takes place in the frames of international companies, the importance of transfer pricing becomes clear.[OECD]

As one of the few legal offices in Poland, we do specialize in providing full services concerning transfer pricing. Our main aim is to ensure legal, financial and tax safety for management boards and companies managed by them.

We regard the issue of transfer pricing widely and this is why the range of our services includes:

- Preparing documentation of transfer pricing,
- Preparing so-called transactions descriptions,
- Creating the transfer pricing policy taking into account duty aspects,
- Drawing up comparative analysis (benchmark studies, benchmark analysis),
- The defence of the transfer pricing documentation and applied,
- Transactions pricing..