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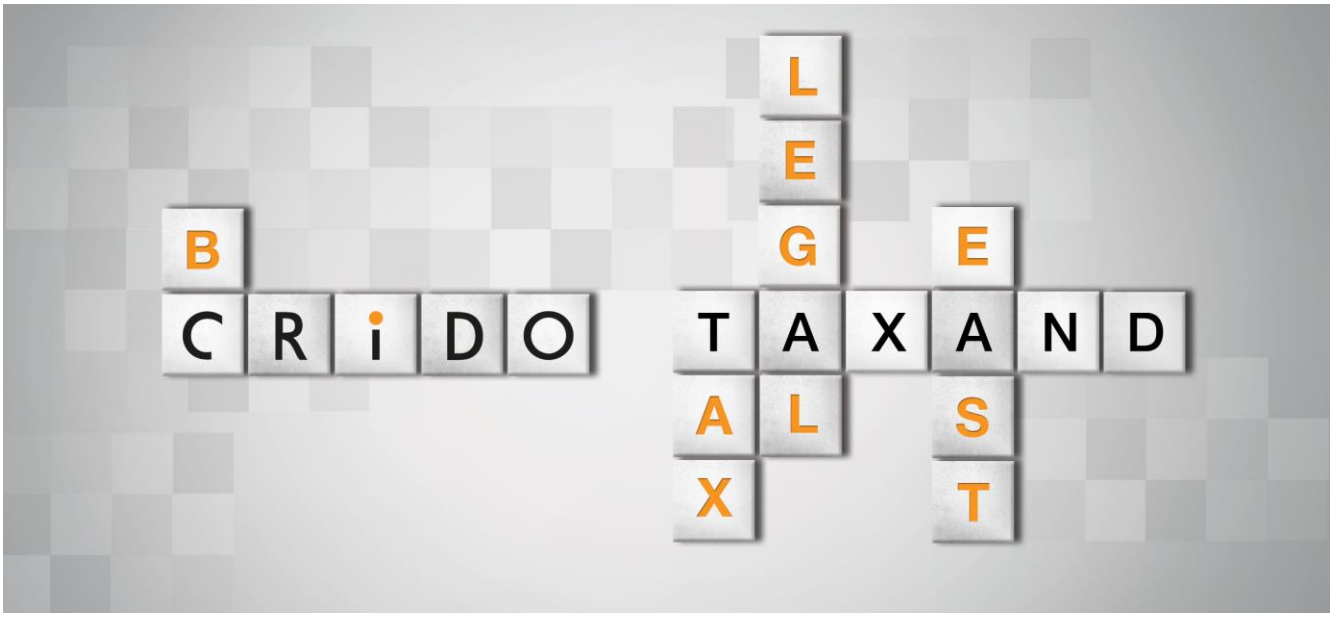

CRIDO TAXAND FLASH – AUGUST 2016

TOPICS OF THE MONTH

- **Draft regulation on e – receipts published for consultation.**
- **Another attempt at supporting innovative activities.**
- **General reverse charge – a new way of tackling VAT frauds?**
- **Ministry of Finance again boasts about results of TP controls.**
- **Transfer pricing control – is transfer pricing documentation interesting for tax inspectors?**
- **Retail sales tax controversies.**
- **Concerns regarding taxation of liquidation of LLC – update.**
- **Tax authorities lifted off the leash?**
- **Act targeting CIT Law loopholes adopted by the Polish Senate (with amendments).**
- **Whip on VAT fraudsters.**

DRAFT REGULATION ON E – RECEIPTS PUBLISHED FOR CONSULTATION

After the introduction of regulations on data reporting in Tax Audit File (TAF) format time has come to regulate the issue of the so-called e-receipts. Ministry of Development published for public consultation a draft regulation on the criteria and technical conditions to be met by cash registers.

This is another tool that will allow for the creation of a central system for analysis and control of transactions made by taxpayers. The implementation of the system and fiscal devices suited to centralized reporting of transactions will help to reduce the grey economy and thus increase budget revenues.

The planned changes are to ensure:

- digitization of documents and fiscal reports,
- transmission of data from cash registers to the central repository,
- advanced analysis of fiscal data.

It is important to note that electronic documents of both fiscal and non-fiscal nature are to be stored in the protected memory of cash registers in a form corresponding to the logical structure of TAF.

In short - Ministry of Finance will be able to faster gain more information on payments and transactions made with consumers.

Regulation should enter into force on 1 January 2018.

ANOTHER ATTEMPT AT SUPPORTING INNOVATIVE ACTIVITIES

On 16 August the government adopted a package of measures aiming at new incentives for innovative activities - in particular by means of tax reliefs.

The act amending certain laws defining the conditions for conducting innovative activity provides for a number of changes to CIT and PIT regulations:

- **in-kind contribution of commercialized intellectual property should be exempt from tax;**
- **the list of expenses regarded as eligible costs within the relief on R & D activity will be extended by expenses associated with obtaining patents** for inventions, protection rights for industrial design and rights from registration of industrial designs incurred by micro, small and medium-sized enterprises;
- **the limit of eligible costs is to be increased up to 50%,** for all costs of micro enterprises and SMEs and employment costs of large companies and 30% - for other costs incurred by large enterprises;
- **the introduction of possibility of obtaining an amount equal to 18% or 19% of not deducted eligible costs** (for, respectively, the progressive PIT rate or linear PIT rate / CIT taxpayers) **for new companies that suffer a loss or report tax profit that does not allow for full deduction of eligible costs.** Micro-entrepreneurs and SMEs will benefit from this privilege within 2 years from creation, and large enterprises - within the first year of start of their activity (however, if the company is dissolved within 3 years of its foundation, the amount

obtained will need to be returned). The payment of amounts discussed will be made in a form of a tax refund (a proper change is to be introduced to the Tax Ordinance).

The draft regulation should be now submitted to the lower chamber of Polish parliament (Sejm). The new regulations should be binding from 1 January 2017.

GENERAL REVERSE CHARGE – A NEW WAY OF TACKLING VAT FRAUDS?

On 17 June 2016 ECOFIN Council published a report on the meeting, where it was agreed that the Council is to present a draft of regulation introducing the possibility for the Member States to implement a general reverse charge mechanism in relation to domestic transactions exceeding a certain threshold.

In general, the reason for introduction of the possibility to settle tax by means of reverse charge is to improve VAT collection and counter VAT frauds. Under this mechanism the obligation to settle VAT is shifted from the seller to the purchaser. Standard scheme involves a payment to the budget at each stage of supply chain. In the case of reverse charge the tax is not paid until the goods are sold to the final consumer. VAT payment is transferred to the budget after the retailer sells the product. In principle, VAT refunds extortion are not possible under this mechanism.

Presented mechanism has both its supporters and opponents. Some argue that its introduction is a success of lobbyists, because in practice no participant of the supply chain / provision of services pays VAT and the budget loses as it becomes a hostage to the last deal within the supply chain. Others say, however, that this mechanism is the only effective remedy for VAT fraud and extortion.

What is the truth? In my opinion, the truth, as usual, it lies somewhere in the middle. An analysis of the structure of budget revenues shows that it is mainly based on VAT inflows. The introduction of the reverse charge mechanism results in a lack of such inflows resulting from transactions relating to goods / services covered by the reverse charge mechanism at different stages of supply chain and consequently their decline (not all products / services get to the final consumer; part of them is used by the taxpayer in the production process). On the other hand, according to the latest ZIPSEE report "Digital Poland" the number of VAT fraud has plummeted in industries of smartphones, tablets, laptops and game consoles. This results from the fact that these products have been covered by reverse charge mechanism since July 2015. Of course VAT fraud is still an issue when it comes to other goods/branches but no one has yet invented another effective way of tackling VAT fraud. Perhaps the solution would be to apply an universal reverse charge?

The idea to introduce an universal reverse charge came as early as 2006 in Germany and Austria which submitted to the European Union Commission a request for a derogation from the principle of universal tax on domestic supplies of goods / services exceeding a certain threshold. The Commission then rejected the request saying that in light of the provisions of the Sixth Directive effective at the moment, such measures preventing certain forms of tax evasion or avoidance constitute substantial derogation from the EU law, hence provisions of the VAT Directive would have to be amended first. In 2015 Czech Republic submitted a similar request. This attempt also failed, but it seems that this issue has become part of the international discussion on effective ways to fight VAT frauds.

On 17 June 2016 ECOFIN Council published an outcome of the meeting, where a draft EU directive introducing legislation against tax evasion affecting the internal market was agreed. The document **stated that the EU**

Commission is obliged to propose, before the end of this year, a draft regulation introducing the possibility for the Member States to derogate from the general VAT system in order to implement a general reverse charge mechanism in relation to domestic transactions exceeding a certain threshold.

Member States which considered such solutions are aware of its disadvantages. First of all, it would mean changing the foundations of VAT as it would become a tax on retail. Other issues are high cost of implementation of a VAT settlement system completely different from the current one and making budget revenues dependent on the last dealing in the supply chain. Yet, total elimination of VAT fraud is the main benefit of universal reverse charge. Honest taxpayers who were previously controlled due to a more or less reasonable suspicion of participation in illegal practices could, in turn, focus on their business rather than defend their good name in front of the tax authorities. Moreover, significant reduction of administration would also reduce the operating costs of the state. The question is whether the budget will endure the cost of losses in the long term. The discussion remains open, at least until the European Union Commission publishes draft of new EU legislation.

MINISTRY OF FINANCE AGAIN BOASTS ABOUT RESULTS OF TP CONTROLS

Deputy Minister of Finance Wieslaw Jasinski presented the results of tax inspections for the first half of 2016. Following the recent trends, a significant number of audits were related to TP.

Deputy Minister stressed that tax controls focus on transfer pricing and tax optimization. In the first half of this year 222 control proceedings were started in this regard.

Deputy Minister pointed out that *"controls on transfer pricing in income taxes resulted in determining tax liabilities of more than PLN 60 million and decreasing the amount of declared losses by more than PLN 440 million. In terms of tax optimization – the controls resulted in determining tax liabilities of PLN 560 million and reducing the declared losses by more than PLN 27 million. "*

"The introduction of the new provisions to the Tax Ordinance - a general anti-abuse rule - will probably lead to more intensification in this regard. He explained that fiscal control is the main formation, which conducts inspections of transfer pricing applied in transactions between related parties and activities aimed at the so-called tax optimization".

Source: PAP (link)

TRANSFER PRICING CONTROL - IS TRANSFER PRICING DOCUMENTATION INTERESTING FOR TAX INSPECTORS?

Transfer pricing documentation (further: the Documentation) by legislator's constitutes a special and key evidence in the process of verifying whether the conditions of transactions performed between related parties are arm's length. It is a taxpayers' duty to prepare the Documentation.

As a rule, audit of the Documentation can be carried out in two areas (stages):

1. Verification of the internal cohesion of the Documentation

In this area inspectors can focus on any inconsistency or incoherency, possible shortcomings of the reasoning or logical errors of the document.

2. Examination of Documentation's compliance with facts determined on the basis of additional evidence

Tax inspectors certainly can request materials to which the taxpayer refers in the Documentation, e.g. benchmarks, any research papers, reports or studies concerning the market situation. They can also assess the reliability of the Documentation for given facts. This can be done by requesting documents related to each stage of the transaction, the inspectors can verify the actual functions performed within the transaction on the basis of information on the assets and personnel and organizational resources of the taxpayer (submitted at their request). Moreover, tax inspectors can verify expenses incurred and booked by the taxpayer, for example, in connection with the performance of functions within the transaction or provision of services / purchase from the related party.

Negative outcome of Documentation's inspection may entail serious tax consequences:

- Firstly, tax inspectors on the basis of the Documentation and other source materials may question the nature of the transaction (its conditions) in the light of its reasonability and its sufficient documentation.
- Secondly, the effect of the revision of the Documentation (along with the source materials) may lead to examination of the functional analysis prepared by the taxpayer (including the assets and risks identified) and conclusion that it does not represent the actual distribution of economically important functions between the parties involved in the transaction.

Consequently, in both of the aforementioned cases, the tax authority may decide to carry out estimation (e.g. by a revision of the comparative analysis done on the basis of the information from the transfer pricing documentation), or may decide to question the expenses incurred by the taxpayer as tax deductible costs.

Bearing in mind that transfer pricing and tax optimization cases have been treated by tax authorities as *high profile* and the fact that inspectors began to be more fluent in these areas, taxpayers should be aware of the need to properly document transactions with related parties. This will be even greater challenge as the Documentation is only a secondary source , so in the course of the proceeding the inspectors will verify whether the Documentation is coherent with the actual conditions of the transaction.

In practice, every inconsistency or doubt - both "internal" resulting from the content of the Documentation and "external" resulting from comparing the Documentation's content with the source materials (other evidence), may result in challenging the terms of the transaction as violating the arm's length rule.

RETAIL SALES TAX CONTROVERSIES

Starting from 1 September 2016 major retailers will have to deal with provisions of the Act on tax on retail sales. The aforementioned Act – despite its small volume – creates a number of practical questions concerning its interpretation.

Let us recall briefly the basic principles of the Act:

- the tax base will constitute a revenue surplus from retail sales of over PLN 17M reached in a given month;
- the tax is progressive – there are two rates:

  - 0.8% of the tax base between PLN 17M and 170M,
  - 1.4% of the excess of the tax base over PLN 170M,
- taxpayers whose monthly revenues from the sale will not exceed PLN 17M will be exempt from tax and are not required to file tax returns,
- online sales and revenues from the sale of drugs, foodstuffs intended for particular nutritional uses and medical devices reimbursed or (co) financed from public funds as well as products such as, among others, electricity or gas fuel will be excluded from the tax.

The discussed provisions are in many aspects underdeveloped. For example, settlements of discounts or exchange of goods may cause problems. There are also doubts about different aspects of online sales and taxation of the services provided along with the sale of goods.

It is also worth noting that contrary to the legislator's intentions, in practice, the **higher tax rate – of 1.4% - will apply to monthly revenues exceeding PLN 187M** (that means PLN 17M + PLN 170M), **instead of PLN 170M,** as declared in the explanatory memorandum to the bill.

So many uncertainties and ambiguities on the part of the legislator create a whole spectrum of risks in the activity of entrepreneurs engaged in retail and in their settlements with tax authorities.

In this context, it is worth mentioning that foreign retailers want to challenge the new tax to the European competition authority.

CONCERNS REGARDING TAXATION OF LIQUIDATION OF LLC – UPDATE

Despite the favourable judgment of the Provincial Administrative Court in Lodz of 19 April 2016 (ref. I SA / Łd 146/16) the administrative courts may rule that liquidation of share-holding companies is subject to CIT.

Unfavourable position on this issue was presented in the judgment of the Provincial Administrative Court in Poznań of 21 April 2016 (ref. I SA / Po 2430/15). Similar approach was adopted by the Provincial Administrative Court in Gliwice in in the judgement of 18 May 2016 (ref. No. I SA / Gl 1264/15) stating that shareholder's withdrawal from a limited partnership resulting in transfer of part of the partnership's assets in his favour creates revenue of the remaining shareholders.

Has the line of interpretation changed?

Tax authorities claimed for a long time that the fulfilment by a company of any obligations to its shareholders in a form other than monetary (e.g. through transfer of real estate) means taxable income for the company. Most of the administrative courts took a different view, stating that such operation is CIT neutral for this company.

Since 1 January 2015 Article 14a was introduced to CIT Act to dismiss doubts in the matter. According to this provision, as a general rule, when a taxpayer provides a non-cash benefit to fulfil its obligation resulting from, e.g.

- loan agreement,
- dividends,

- redemption or disposal for redemption of shares

taxable income in the amount of the settled liability should be recognized.

What is the source of trouble then?

According to tax authorities provisions of Article 14a should be applied also to transfer of assets of a liquidated LLCs/joint-stock company as it is a situation similar to sale of the company's assets and distribution of cash to the shareholders.

Tax authorities do not recognize the fact that Article 14a does not mention "liquidation of a shareholding company". In addition, the transfer of assets of a liquidated company to its shareholder, compared to sale of assets, does not involve any payments by the shareholder. Therefore, there are doubts concerning potential taxable income that should be recognized by the liquidated company.

What is the administrative courts' position?

The first judgment concerning the application of Article 14a to a liquidation of a shareholding company was issued as early as in 2015. In this judgment the Provincial Administrative Court in Wrocław stated that transfer of assets of a liquidated shareholding company should imply taxation.

On the contrary, the Provincial Administrative Court in Lodz pointed out that the transfer of assets to the shareholders of the liquidated company is not similar to sale of assets. Consequently, it should be CIT neutral for the liquidated company.

Unfortunately, the subsequent judgments of the administrative courts were not as favourable for taxpayers as the judgment of the Provincial Administrative Court in Łódź. For example, in the aforementioned judgment of the Provincial Administrative Court in Poznań it was stated that transfer of assets by a foreign controlled company (CFC) in the course of its liquidation to the Polish shareholding company will create taxable income pursuant to Article 14a.

A similar view was presented by the Provincial Administrative Court in Gliwice – a taxable income should be recognized by partners of a partnership when one of the partners withdraws from the partnership and receives part of its assets.

The future will show how the case law of administrative courts shapes. At the moment, transfer of assets in the process of liquidation of LLC involves risk of a taxable revenue for this company.

TAX AUTHORITIES LIFTED OFF THE LEASH?

In the first half of this year tax authorities issued decisions amounting to PLN 9.6B which is an increase of almost 37% compared to the previous year. According to the estimations of the Deputy Minister of Finance, Wiesław Jasinski, by the end of this year this amount should significantly exceed PLN 20B.

As a result of the inspectors' actions the budget was supplied with a total of PLN 566.5M (an increase of 36% compared to the previous year), and the amount of retained VAT refunds amounted to PLN 266.1M (an increase of 288%). Ministry of Finance finds it as a source of pride, but do entrepreneurs share this feeling? Analysis of these figures easily leads to a conclusion that only 5.8% of decisions of tax authorities were not questioned by taxpayers. However, it can be hard for taxpayers to "endure" in a dispute with tax authorities until the final decision is issued

after all instances. A stock-listed company recently announced that as a result of actions of tax authorities which could lead to its insolvency, it needs to implement a recovery program. So far VAT settlements and transfer pricing are of special interest for tax authorities. Is it then worth to prepare for tax inspections in advance? Everyone should ask themselves the following questions: will the company handle having its funds blocked as to secure potential claims or will the company's liquidity be at risk if VAT refunds are withheld, will the bank block / reduce financing when it becomes aware of the decisions of tax authorities, do we have procedures for inspection in place that would allow to present a coherent explanation and documents in a timely manner, can we manage the criminal and fiscal liability risk? No one likes to be controlled, especially when control comes as a surprise.

ACT TARGETING CIT LAW LOOPHOLES ADOPTED BY THE POLISH SENATE (WITH AMENDMENTS)

Recently, the Polish Senate adopted an act providing for, i.a. the reduce CIT rate for small taxpayers and regulations restricting the use of tax optimization measures .

In the course of legislation process the Polish Senate also introduced minor amendments to the Act, mainly of editorial nature.

For the record, the Act provides for, among others, new rules for taxation of the in-kind contribution with share premium, including e.g. an anti-abuse clause for restructurings, real estate clause and a beneficial owner definition.

The reduced CIT rate of 15% is to apply to (i) taxpayers whose sales revenues (including the amount of due VAT) did not exceed the equivalent of EUR 1.2M in the previous fiscal year and (ii) taxpayers starting their business in a given fiscal year.

Because of the amendments the act will be reverted back to the lower-house of the Polish Parliament (Sejm) which will vote on the proposed amendments.

WHIP ON VAT FRAUDSTERS

Draft act amending the Penal Code prepared by the Minister of Justice was published on the website of the Government Legislation Centre. The draft provides for new tax offenses such as invoices falsification aiming at VAT fraud and includes severe penalties, up to 25 years in prison.

The Criminal Code – and not the Fiscal Penal Code (which is by the way is interesting) – will provide for new rules that will penalize acts such as:

- forgery / rework i.e. invoices falsification,
- issuing false invoices,
- the use of such invoices

when it is relevant for determining the amount of public receivables.

What does it actually mean for honest taxpayers?

The draft's main objective is to deter VAT fraudsters. However, it seems that the shape of the proposed regulations may raise the risk of criminal liability for a taxpayer who uses such invoices in its settlements and makes VAT deductions on its basis. For instance, the risk may occur when taxpayer uses in settlements (even unconsciously) the

so-called "blank invoices" or invoices received from the so-called "missing trader" who aimed to extort VAT. Such invoices can be recognized by the tax authorities as "false" – consequently VAT deductions based on such invoices may result in criminal liability of 6 months to 8 years in prison.

What is more, the project provides for fixed minimum penalties of prison, i.e. 6 months, and in some cases even 3 years. The penalty of 25 years of prison is to apply in cases of counterfeiting, issuing false invoices as well as their use in relation to goods or services of value greater than five times the amount of the property of *great value* as defined in the Code, ie. PLN 5M.

The sanction of imprisonment will surely fulfil a preventive function. The question is whether the judges will decide severe prison sentences for tax offenses defined in the Penal Code? Time will tell, but at the moment it is difficult to imagine that someone could be sentenced to 25 years in prison for a tax fraud.

SHOULD YOU HAVE ANY ADDITIONAL QUESTIONS CONCERNING THE ABOVE ISSUE, PLEASE CONTACT:

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