Tax&Legal Highlights

Poland

Importance of R&D analysis, in particular for IT sector

IT is one of the fastest growing sectors. Technological advance requires continuous development and design of broad application solutions. It is fairly clear that many types of work performed by this sector entities may be classified as R&D under the applicable criteria.

What qualifies as R&D in the IT sector?

Any work involving development of new algorithms in computer science, development of operating systems, among others programming languages, data management, communication and programming tools is considered R&D in the IT sector. At the same time, certain activities cannot be considered R&D. These include designing websites and applications, or software using the existing tools, as well as routine debugging.

From the perspective of tax exemptions, such as **R&D allowance** or **IP BOX (Innovation Box)**, correct definition of business operations and verification whether it complies with the definition of R&D as provided in CIT and PIT Act (Article 4a.26 and Article 5a.38, respectively) is of key importance. Under the definition, R&D must be carried out on a regular basis, with the purpose to grow the knowledge base and thus allow new

uses of the developed solutions. Correct definition of the R&D framework underlies identification of eligible expenses, which determine the amount of deductions from the tax base when using the R&D allowance.

Theoretically (in particular in the IT sector), ongoing **operations involving the development of software and supporting tools**, brand new from the business perspective and allowing new, so far unknown functionalities, or proprietary software versions customized to a given client, qualify as R&D. Generally, interpretation practice indicates that such types of development carried out in IT entities is considered to be R&D.

However, from the viewpoint of project-life based R&D analysis, **doubts arise** regarding the timeframe, i.e. which stage of the ongoing work should be considered the commencement and completion of R&D activities.

R&D: doubts regarding IT project implementation

Ii is easier to analyze inn case of **working on a new concept**: usually, based on the observation of market standing, client needs or a specified order, the author starts building the concept from scratch. The work involves a number of risks and uncertainties, related either to the manner of implementing the idea, or achieving the desirable outcome, which helps qualifying it as R&D.

The implementation stage, though, following the completion of the testing and modification, may give rise do doubts. In practice it means the completion of R&D work. However, the nature of activities involving for example integration with the existing software and system components (which may require substantial modifications of the implemented solution and return to the stage of product development, iterations and testing) may allow different interpretation. Due to fairly creative nature of the implementation stage performed in such a manner, bearing substantial risk of failure, doubts occur as to whether such activities, by no means considered routine and involving material innovation, are unfit to qualify as R&D. Since the implementation work is inconsistent in nature, it seems fair and justified to meticulously analyze the stage and separate routine activities from those qualifying As R&D. Further, the growing specialization of technological processes, including those performed in the IT sector, quite frequently requires cooperation of many independent entities to contribute specialistic knowledge and work together for a time being during the project life, both in the concept development and implementation stage. In light of the above, during verification of the performed operations for compliance with the R&D definition, the type and nature of work carried out by each project participant must be checked, which may, consequently, broaden the scope of R&D activities performed.

Of course, each case will be different, which may require a highly individualized approach. Anyway, from the perspective of a project that may involve large R&D potential, such an analysis is highly reasonable. Therefore, it seems appropriate to precede each analysis with a broad view of the potential project scope over its entire life cycle, and only then restrict the analysis of R&D activities to specific fields. Practice indicates that **only this approach allows good understanding of the nature of operations, analysis and verification of each implementation stage** in the context of the statutory R&D definition, resulting in a correct specification of eligible costs underlying the settlement of R&D allowance.

R&D activities carried out by businesses: more than just a tax allowance

Considering the scope of R&D activities carried out in the context of **R&D allowance** or **IP Box (Innovation Box)**, we cannot forget other incentives and preferential treatment offered to innovative businesses.

First and foremost, at present most businesses may obtain co-funding of operating expenses, mostly under **Submeasure 1.1.1 of POIR Szybka Ścieżka (Intelligent Development Operational Program, Fast Pathway)** (general and specialist topics, e.g. Plastics), as well as under sectoral measures, e.g. **Measure 1.2 POIR GameINN** (a competition intended for game and videogame producers), as well as expenses for the purchase of R&D infrastructure (**Measure 2.1 in POIR**).

At the same time, taxpayer's activities involving the participation of its employees in many cases allow the employees to calculate **50% tax deductible expenses**, which translates into higher net salary, while employer's costs remain fairly unchanged.

Thus, R&D activity carried out or planned by a business should be analyzed in light of the large choice of tax incentives and co-funding available, to allow turning it into both increased opportunities and competitive advantage.

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PSD2: changes awaiting payment service providers after 14 September 2019

On 14 September 2019, regulatory technical standards regarding strong customer authentication [1], supplementing PSD2 Directive, came into effect. They changed the manner of authentication related to payment transactions, introducing a two-step strong customer authentication standard.

Strong customer authentication (SCA) means authentication based on at least two components of the following classes:

- knowledge (something only the user knows, such as a code or password);
- possession (something only the user possesses, e.g. a mobile application);

- inherence (something the user is, e.g. biometrics in the form of a fingerprint);

that are independent, in that the breach of one does not compromise the reliability of the others, and is designed in such a way as to protect the confidentiality of the authentication data.

Payment service providers use strong customer authentication where a payer:

- accesses its payment account online;
- initiates an electronic payment transaction;
- carries out any action through a remote channel which may imply a risk of payment fraud or other abuses.

As a result, banks modified their login procedures to achieve compliance with the new requirements.

Please note that payment service providers shall be allowed not to apply strong customer authentication, where the payer initiates a contactless electronic payment transaction provided that the following conditions are met:

(a) the individual amount of the contactless electronic payment transaction does not exceed EUR 50; and

(b) the cumulative amount of previous contactless electronic payment transactions initiated by means of a payment instrument with a contactless functionality from the date of the last application of strong customer authentication does not exceed EUR 150; or

(c) the number of consecutive contactless electronic payment transactions initiated via the payment instrument offering a contactless functionality since the last application of strong customer authentication does not exceed five.

Please note that on 18 August 2019 Polish Financial Supervision Authority announced its plan to allow the supervised payment service providers not to apply the SCA requirements with regard to:

- Internet card-based payments and
- contactless payments in terminals.

Thus, PFSA joined the group of the European regulators (including those from the UK, Germany, France and Italy) who decided to take a similar step. Certain payment service providers are allowed not to use the strong customer authentication based on the opinion of the European Banking Authority (EBA) of 21 June, in which, having evaluated the readiness of the European market to adopt the new requirements, it allowed national oversight bodies to extend the time certain providers needed to achieve compliance with the new regulations, on certain conditions. In order to use the exemption, payment service providers need to submit an appropriate motion to the Commission, along with a migration plan. In such cases, other supervisory measures related not using SCA, shall not be applied to these providers. The solution, though, is not perfect, since even in such cases, the risk related to not using SCA after 14 September 2019 as required by PSD2 and RTS shall be borne in whole by the obligated payment service providers.

[1]. Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication.

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Excise duty exemption for Lubricating Preparations. Draft Regulation amending the Regulation on Exemptions from Excise Duty was published yesterday

The draft Regulation of the Minister of Finance amending the Regulation on Exemptions from Excise Duty (henceforth: "Draft") is available on the website of the Government Legislation Center. The draft introduces excise duty exemption for lubricating oils coded CN 27102090 and lubricating preparations coded CN 3403 (henceforth jointly: "Lubricants") used for purposes other than broadly defined propulsion, heating or as engine lubricants.

What is this all about?

Following the effective date of the Act Amending the VAT Act and Certain Other Acts of 4 July 2019 (Journal of Laws of 2019, item 1520, henceforth "Fuel Package 2.0") as of 1 September 2019, lubricating oils coded CN 27102090 are subject to the excise duty rate of PLN 1,180/1000 liters, while lubricating preparations coded CN 3403, except for lubricant paste, shall be included in the same excise rate as of 1 November 2019. Introducing the amendment, the lawmakers intended to equalize the taxation of Lubricating Oils and Lubricating Preparations. Therefore, along with applying the same excise rate, the lawmakers allow the same exemptions as currently available for Lubricating Oils to be applied to Lubricating Preparations.

The draft allows an exemption from Article 6.2 of the Regulation of the Minister of Finance on Exemption from Excise Duty (Journal of Laws of 2018, item 2525; henceforth: "Regulation on Exemption") also for Lubricating Preparations, if their intended use differs from propulsion or heating, or being additives to engine fuel, or as lubricant oils used in engines, or in production of engine fuel, heating oil, additives to engine fuel or to lubricant oils used in engines. The effective date as projected in the Draft falls on 1 November 2019.

Please note that the effective excise rate has been applied to the lubricating oils coded CN 27102090 as of 1 September 2019. The regulation introducing an exemption regarding these products (if the regulation remains unchanged) shall come into effect as of 1 November 2019. Therefore, until the end of October, Lubricating Oils bearing the code CN

27102090 cannot be excise exempted, if their intended use is different than broadly defined propulsion, heating or engine lubrication.

What does this mean in practice?

The draft does not change any formal terms qualifying for the exemption, thus making the provision of a document of supply the sole condition underlying the exemption. As of 1 January 2020, following the replacement of paper documents of supply with their electronic form, generating an e-DD communication and sending it to the EMCS system will be a condition allowing the use of the exemption.

Importantly, the lawmakers do not intend to change any transaction schemes to which the exemption applies. Thus, for intra-Community purchases of Lubricating Oils and Preparations, moving the goods to a tax depot (owned or hired) shall be the prerequisite allowing the use of the exemption, which may involve a change in the delivery pattern of these goods vs. the one applied at present.

When the exemption is applied based on the intended use, companies will be obligated to keep consumption records of these products on terms determined in excise-related regulations.

Follow-up

Entities that purchase Lubricating Preparations in Poland and intend to use the exemption shall be obligated to register for excise purposes (those already registered shall update their forms) and obtain access to the EMCS System, which is necessary to confirm the delivery of these products in the System. Therefore, appropriate preparation (developing procedures and training employees) would be necessary to allow the electronic monitoring.

Entities that make intra-Community purchases of Lubricating Preparations and do not use tax depot may consider changing the procurement model and commence cooperation with a tax depot, in order to be able to use the discussed exemption. Alternatively, should they decide not to use the exemption, a special tax regime, intended for intra-Community purchases, shall be applied, which will require the performance of certain measures prior to the submission of returns and tax payment.

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