

Transfer Pricing - Poland Significant changes to documentation requirements - update Tax Alert 06/2015



Poland plans to introduce significant changes to the transfer pricing documentation requirements. The updated Draft Amendments to the Corporate Tax Acts including comments received during public consultations were published on the website of the Polish Government Legislation Centre on 18 June 2015. Additionally, drafts of two ordinances of Ministry of Finance were published (i.e. the draft ordinance on detailed description of the elements making up the tax documentation and the draft ordinance establishing the model report prepared to analyse the risk of taxable income underreporting in transfer pricing and to exchange information with competent foreign authorities in the scope of corporate income tax ("*Country-By-Country Reporting*"), as well as a template form collating information of related-party transactions that is to be attached to annual tax returns. The update of the draft amendments to the CIT Act along with the two implementing regulations and the CIT-TP form should be seen as further steps in the process of incorporating new guidelines regarding the transfer pricing documentation and disclosure of information concerning such transactions that began in April this year. The date that the new documentation requirements are to enter into force has not been announced yet, because legislators are still working on the wording of the regulations at issue. It is, however, expected that the new rules should apply to the transactions carried out in 2016 or in 2017.

Entities obliged to prepare transfer pricing documentation – update

The draft legislation introduces a three-tiered approach to transfer pricing documentation, i.e. local documentation ("*Local File*"), documentation for groups of companies ("*Master File*") and a report on global allocation of income and tax within the group ("*Country-By-Country Reporting*").

According to the updated draft legislation **the obligation to prepare transfer pricing documentation** will, as a rule, apply to taxpayers whose revenues or costs exceed the equivalent of EUR 2 M in the year preceding the tax year that the transfer pricing documentation is to be prepared for. The transfer pricing documentation obligation concerns related-party transactions as well as **other events** recorded in the books of accounts for the specific year, **the terms of which have been determined (or imposed)** with related parties, **where such events have material impact on the taxpayers' income (loss) amount**.

The draft provides that the new transfer pricing documentation requirements will also apply to taxpayers that conduct their business operations without having legal personality (e.g. partnerships) giving them the possibility to appoint a partner responsible for drafting the documentation. In such a situation the limit of revenues or costs the exceeding of which triggers the obligation to prepare transfer pricing documentation will apply to the partnership.

Taxpayers whose revenues or costs exceed the equivalent of EUR 10 M in the year preceding the tax year will be additionally obliged to prepare benchmarking studies.

If the taxpayer's revenues or costs exceed the equivalent of EUR 20 M in the year preceding the tax year, the taxpayer will be obliged to prepare documentation that will additionally contain information about the whole group of related parties ("*Master File*").

As regards the largest entities whose consolidated revenues exceed the equivalent of EUR 750 M in the year preceding the tax year, there will be an obligation to produce a report on the income and tax paid in by subsidiaries, their places of conducting business as well as their permanent establishments ("*Country-By-Country Reporting*").

Scope of transfer pricing documentation – update

In line with the updated draft legislation, taxpayers will be under an obligation to draw up tax documentation not only in respect of their transactions with related parties but also concerning other events recognized in the books of accounts **where such events have a material impact on the taxpayers' income (loss) amount**, as well as other events the terms of which have been determined (or imposed) with their related parties, including the contracts for finance management (e.g. cash pooling), cost sharing agreements, agreements related to incorporation of entities that are not legal persons, joint venture contracts and other comparable agreements.

The materiality criterion has been defined in quantitative and qualitative terms, i.e. material transactions or other events are transactions or events of **the same kind** whose aggregate value exceeds the equivalent of EUR 50 000 in a tax year.

In addition, the amendments provide certain materiality thresholds depending on the taxpayer's revenues. Namely, transactions are deemed material for taxpayers, if in the year preceding the analysed tax year the taxpayer's revenues exceeded the following thresholds:

- EUR 2 M but not more than EUR 20 M – transactions or other events of the same kind whose total value exceeds the equivalent of EUR 50,000 increased by EUR 5 000 per each EUR 1 M of revenues in excess of EUR 2 M are considered material;
- EUR 20 M but not more than EUR 100 M – transactions or other events of the same kind whose total value exceeds the equivalent of EUR 140 000 increased by EUR 45 000 per each EUR 10 M of revenues in excess of EUR 20 M are considered material;
- EUR 100 M – transactions or other events of the same kind whose total value exceeds the equivalent of EUR 500 000 are considered material.



Content of transfer pricing documentation – update

The documentation prepared by taxpayers whose revenues or costs do not exceed EUR 10 M in the year preceding the tax year in question should contain:

1. description of the transactions or other events, also contracts for finance management and cost sharing agreements, including:
 - a) indication of the type and the object of the transactions or other events,
 - b) financial data, including cash flows related to the transactions or other events,
 - c) indication of the related parties executing the transactions or other events,
 - d) description of the course of the transactions or other events, including the functions performed by the parties to the transactions, the assets engaged – also non-balance sheet assets – the human capital and the risks borne,
 - e) description of the method and manner of calculating the income together with justification of their choice, including the algorithm for settling the transactions or other events, together with the method of calculating the values affecting the income (loss) of the taxpayer or the taxpayer's partner,
2. description of the taxpayer's financial data which will make it possible to compare the settlements with the data derived from the approved financial statements where the duty to prepare the financial statements arises from the accounting regulations,
3. description of the taxpayer, including:
 - a) the organizational and management structure,
 - b) the conducted business activity,
 - c) the economic strategy, including the transfers of economically material functions or assets or risks that have impact on the incomes (loss), made between related parties in the given tax year or in the year preceding the tax year,
 - d) business environment,

4. documents, in particular:

- a) agreements or other documents entered into by related parties which document the transactions or other events, agreements related to incorporation of entities that are not legal persons, joint venture contracts and other comparable agreements,
- b) documents that lay down the rules of the rights granted to partners (parties to the agreement) in respect of their participation in profits and losses,
- c) income tax agreements concluded with tax authorities concerning transactions and other events, especially advance pricing agreements.

As regards taxpayers whose revenues or costs exceed EUR 10 M in the year preceding the tax year, and taxpayers holding shares in entities that are not legal persons the revenues or costs of which exceed EUR 10 M in the preceding tax year, the documentation should additionally contain a benchmarking study based on benchmarking data used in calculating the intercompany settlements, indicating the source of the data. Based on the updated version of the amendments **this study should contain comparable data concerning entities with the registered office or the management in the territory of the Republic of Poland**, and if such **comparable data is not available to the taxpayer**, then the taxpayer should attach to the documentation a description confirming that the terms of the transactions and other events established with related parties are consistent with the terms that otherwise would have been established by unrelated entities.

Taxpayers whose revenues or costs exceed the equivalent of EUR 20 million in the year preceding the tax year will also be obliged to draw up tax documentation concerning a group of entities (the so-called "Master File") which should contain, *inter alia*:

1. indication of the related party that has prepared the information concerning the group along with the date on which the related party files its annual tax declaration;
2. the organizational structure of the group of related parties,
3. description of the rules for determining transactional prices (group transfer pricing policy) followed by the group,
4. description of the business conducted by the group,
5. description of material intangible assets possessed, created, developed and used by the group,
6. description of the financial situation of the entities comprising the group, specifically including the consolidated financial statements prepared,
7. description of agreements with tax authorities of other countries concerning income tax, especially unilateral advance pricing agreements, concluded by entities comprising the group of related parties.

Other changes – update

Furthermore, the draft amendments include *inter alia* the following obligations and requirements:

- duty to prepare tax documentation not later than until the date of submission of the tax return for the respective tax year (the deadline for the obligation to produce tax documentation at the authorities' call remains unchanged, i.e. within 7 days of the date of being served with the call);
- requirement to have the transfer pricing documentation verified periodically, at least once a year (however benchmarking analyses should generally be subject to verification once every three years);
- obligation to attach a simplified report on transactions with related parties to the tax return - in the case of taxpayers whose revenues or costs exceed EUR 10 M. Information on the draft report is presented later in this alert.

- **obligation to prepare tax documentation (within 30 days of the date of being served with the inspection authorities' call to do so) in respect of the transactions or other events the value of which does not exceed the documentation limits or the materiality thresholds, if the circumstances of the case indicate that their value could have been underreported to avoid the documentation obligation.**

The updated version does not include the requirement to **have a statement confirming preparation of complete documentation within the statutory deadline signed by a member of the management board of the local entity**. On the other hand, the requirement to submit a statement of that kind to the competent tax office not later than until the date of submission of the tax return for the specific tax year has not been removed.

Additionally, the draft amendments modify the current definition of related parties – pursuant to the updated draft, related parties should be understood as entities that possess interest (direct or indirect) in the capital of another entity which is equal to not less than 25% (earlier drafts indicated the threshold of 20%).

New CIT TP form accompanying the annual tax return

The updated draft amendments provide for an obligation to attach a **CIT TP** form to the annual tax return. The taxpayer will use it to disclose detailed information concerning related-party transactions as well as other events on account of which dues are paid to entities seated in tax havens. CIT TP will *inter alia* include information concerning:

- the sector of the taxpayer's business activity (such as production, trade, services),
- the taxpayer's functional profile (e.g. limited risk distributor, contract manufacturer),
- types of related-party transactions (e.g. intra-group services, purchase of intangibles, payment of royalties),
- values of transactions according to their types – transactions up to EUR 10 M and above EUR 50 M,

- materiality of transactions by their type – whether the value of transactions within a specific type exceeds 50% of the value of all related-party transactions.

This document will allow the tax authorities to gather very detailed information about the taxpayer, the types of transactions, their materiality and value. By implication, it appears that CIT TP will become an important tool in the process of selecting entities for tax audits and identifying transactions that will be the focus of the authorities' interest.

In line with the draft legislation the obligation to file the CIT TP form will apply to taxpayers whose revenues or costs within the meaning of the accounting regulations exceed the equivalent of EUR 10 M in the tax year.

Implementing ordinances to the amended Act

The Ministry of Finance intends to introduce two implementing ordinances in order to fine-tune the provisions of the amended Act.

The draft of the first ordinance clarifies the description of the following elements of tax documentation:

- documentation of the local taxpayer (*Local File*):
 - financial data, inclusive of the cash flows related to the transactions or other events,
 - indication of the related parties executing the transactions,
 - description of the course of the transaction,
 - information to be presented as part of the comparable data analysis, including information about potential adjustments of the outcome of the comparable data analysis, adjustments linked with differences in the description of the course of the taxpayer's transaction and unrelated parties' transactions, with indication which party the adjustment applies to,

- documentation at the group level (*Master File*):
 - organizational structure,
 - transfer pricing policy,
 - description of the business conducted by the group;
 - description of the intangible assets possessed, created, developed and used by the group in business activity;
 - description of the financial situation of the entities making up the group.

The draft of the other ordinance introduces a *Country-By-Country Reporting* model. An appendix to the above ordinance includes a template whereby the taxpayer will disclose the income and the tax paid in by its subsidiaries, the places of running business and the geographical locations of permanent establishments.



Comments

The updated draft amendments to the CIT Act, the draft implementing ordinances as well as the new CIT TP form as proposed by the Ministry of Finance may have a significant impact on the scope of the taxpayers' responsibilities in connection with the preparation of transfer pricing documentation. The suggested changes extend the scope of the information about related-party transactions to be provided to tax offices, which might streamline the process of selecting entities for tax audits and the tax audits themselves.

The documents published on the website of the Polish Government Legislation Center confirm that the regulation of transfer pricing issues is a priority for the Ministry of Finance and that the work on implementing the amendments taken into account in the plan of actions set out in the OECD Report on counteracting BEPS ("*Base Erosion and Profit Shifting*"), in particular action 13: "*Re-examine transfer pricing documentation*" and the EU Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (Official Journal of EU C of 27 June 2006) is well under way.

Apart from the significant changes related to the scope of the documentation, it is important also to note that the approach to the language in which the documentation should be prepared has not been changed – the documentation is expected to be submitted in Polish language (the *Local file*, the *Master file* and the *Country-by-Country Report*).

We will follow the progress of work on the draft and will keep you informed accordingly. Should you wish to discuss the impact of the planned amendments on your business activities, do not hesitate to contact us. In our next tax alert we will focus on the draft amendments to the Tax Code concerning Advance Pricing Agreements.

Texts of the new documentation-related laws (i.e. the updated draft amendments to the CIT Act, two implementing ordinances) and CIT TP form are available on the website of the Government Legislation Center: <https://legislacja.rcl.gov.pl/projekt/12271904/katalog/12286361#12286361>

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