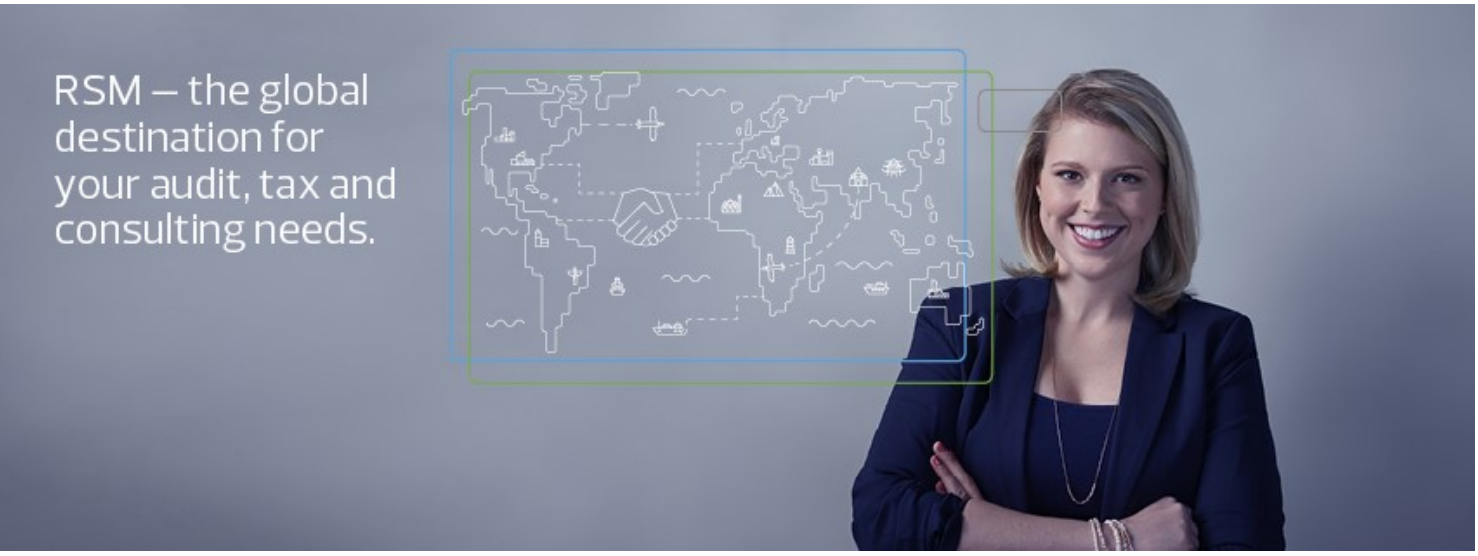

Transfer pricing: punitive tax rate only for 3 years

Tax Alert

Dear Readers,

The tax authority, to apply the 50% punitive rate for the upward adjusted profit between related entities, has only 3 years after the end of the calendar year when the tax liability arose. After that time, until the expiry of 5 years from the end of the calendar year when the tax liability reached its maturity, it may only apply the basic rate of 19%. Such conclusions can be drawn from the judgment of the Supreme Administrative Court of 13 October 2016, ref. No. II FSK 2288/14.

Facts of case
The case concerned a Polish company (hereinafter: Company) performing services for a foreign contracting company from the Netherlands. As a result of the conducted tax audit, it was revealed that the companies were related entities. However, in the opinion of the audit authority, as a result of these relations, the imposed conditions were different from the conditions that would have been agreed between independent entities, which resulted in the recognition by the Company the taxable income at the lower level than it should be. As a result of submission of inaccurate (in the opinion of the audit authority) TP report, the authority determined the Company's profit by estimation, based on the transaction net margin method, by issuing a decision determining the tax liability with the application of the 19% tax rate, as referred to in Art. 19(1) of the Corporate Income Tax Act (hereinafter: CITA). Nevertheless, the company did not agree with this opinion, alleging, inter alia, that the authority issued an assessment decision for 2007 after the expiry of the 3-year limitation period, as referred to in Art. 68 §1 of the Tax Ordinance (hereinafter: TO).

Position of administrative courts
Nevertheless, the position of the applicant has not been first approved by the Provincial Administrative Court in Gorzów Wielkopolski, and then by the Supreme Administrative Court. First of all, the courts of both instances pointed out that the tax that arises under the law and is calculated according to the 19% rate, pursuant to Art. 19(1) of the CITA, should be distinguished from the 50% punitive tax provided for in Art. 19(4) of the CITA. This distinction is of vital importance in determining the limitation period based on the TO regulations.

Moreover, the determination of the amount of the punitive tax is possible only after tax authorities have made all the arrangements required for the application of Art. 19(4) of the CITA, which is possible only by the tax proceeding. As a result, the decision issued as a result of a tax proceeding, which determines the amount of the tax liability, is of a constitutive nature, as referred to in Art. 21 §1(2) of the TO. In the light of this provision, *tax liability arises on the date of receipt of the decision of the tax authority determining the amount of this liability*. Consequently, the limitation period for the so-called punitive tax liability is different than for liabilities arising under the law, as a result of the occurrence of the incident that according to the tax act is connected with the arising of such liability (Art. 21 §1(1) of the TO), and which taxable persons are obligated to

settle by themselves through individual calculation of the tax. In such case, pursuant to Art. 68 §1 of the TO, *the tax liability referred to in Art. 21 §1(2) of the TO shall not arise if the decision establishing this liability has been delivered after the expiry of 3 years from the end of the calendar year in which the tax liability arose*. Nevertheless, it should be noted that in this case the authorities of both instances did not apply Art. 19(4) of the CITA, but Art. 19(1) of the aforementioned act, by using the 19% tax rate.

As emphasised by the Supreme Administrative Court, the court of first instance correctly adopted that in the Company's case, due to the expiry of the limitation period, Art. 19(4) of the CITA could not apply. Therefore, the tax authority correctly determined the tax liability on general principles, i.e. under Art. 19(1) of the CITA. In this case, the 5-year limitation period provided for in Art. 70 §1 of the TO, counted from the end of the calendar year in which the tax reached its maturity, is the correct one to apply. However, **the lack of possibility, due to the limitation, to issue a decision pursuant to Art. 19(4) of the CITA, does not prevent the determination of tax liability in the corporate income tax at the basic rate**. Thus, the plea raised by the appellant concerning the limitation is groundless in the opinion of both courts.

The same position was also expressed in the judgement of the Provincial Administrative Court in Wrocław of 27 May 2010, ref. No. I SA/Wr 283/10.

Moreover, in the analysed judgement, the Supreme Administrative Court referred to the obligation of the ongoing preparation of the transfer pricing reports, claiming that the documents drawn up late, i.e. during and for the purposes of the tax audit will constitute unreliable documentation. Therefore, this judgement is the continuation of the existing jurisprudence, according to which a taxable person should complete the transfer pricing report on an ongoing basis, i.e. at the time of the occurrence of the conditions obliging to its preparation (Supreme Administrative Court of 13 January 2010, ref. No. II FSK 1739/08; Provincial Administrative Court in Bydgoszcz of 20 November 2013, ref. No. I SA/Bd 808/13; Provincial Administrative Court in Gdańsk of 19 June 2013, ref. No. I SA/Gd 529/13). This is a very strong signal for taxpayers who should create the TP reports, for instance for 2016, as soon as possible.

Should you wish to discuss the above mentioned amendments in detail, feel free to contact us:

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22.03.2017