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## | Transfer pricing tax regime in Poland

## Introduction

Foreign entrepreneurs may establish various forms of companies to conduct business activities in Poland. Regardless of the chosen form (limited liability company, limited partnership, a joint-stock company, etc.) and apart from the formal connections between the Polish subsidiary and its foreign shareholder (partner), there is the informal relation of dependency. In multinational enterprises, crucial decisions are made at the ownership level whilst the local subsidiaries must follow the rules and guidelines worked out by the managing entity. It is very uncommon that the local subsidiary is in a position to unilaterally reject the arrangement destined to be binding for the whole group worldwide.

When a foreign investor decides that in order to run the local business properly and assure reasonable profitability in the future, the Polish subsidiary needs to receive extra funding from the investor, gain knowledge or be subject to ongoing supervision, such subsidiary may have to enter into different agreements (loan agreement, management services agreement, administration agreement.) on terms defined by its superior entity (lender or service provider). The question may arise whether there are any limitations with respect to the agreements between the foreign entity and its Polish subsidiary from the legal point of view. Namely, is it acceptable for the Polish company to enter into an unfavorable contract (this can happen since the managing entity may want to negotiate such contract from a position of strength)?

Below are practical comments regarding the consequences of mutual agreements between related entities (foreign investor and the Polish subsidiary).

## Transfer pricing risk

When transactions are concluded with related companies, from the Polish civil law perspective, the parties may determine their conditions freely. This is because the parties to the contract may arrange their relationship in compliance with their common intention if the content and purpose of such contract is in line with statutory law and the so-called "principles of community life".

When, however, the conditions of such transactions differ from the conditions that would be agreed by unrelated entities, the Polish company might not, in effect, show its income or show income that is lower than might be expected from comparable transactions between unrelated companies. For example: the Polish company shows a taxable income from its core business activity but it is consumed by relatively high costs of an intra-group loan interest paid to the investor abroad and consequently there is no corporate income tax to be paid in Poland.

In such cases, according to the Polish tax regulations, the tax authorities may compare the conditions adopted between the foreign investor and the Polish subsidiary with any other comparable market condition agreed between independent entities. On that basis the authorities may disregard conditions agreed between related parties (particularly prices of services and goods) claiming that the transactions are not economically justified for the Polish entity and the so-called arm's length principle (market price principle) is not applied.

As a result, the tax office may assess the tax result of the Polish company disregarding either wholly or partially, the costs that arose as a consequence of transactions with its shareholder (interest on intra-group loans, remuneration for services provided from abroad, costs of goods purchased from the foreign entity, etc.).

## Transfer pricing tax documentation

It is worth noticing that the said Polish transfer pricing regulations generally follow the OECD rules in this area and in most areas are similar to the principles adopted by other EU countries.

It must be underlined that the above mentioned risk of the tax authorities taking such action (transfer pricing risk) is only in respect of transactions between related parties. In accordance with Polish corporate tax law, if one entity participates directly or indirectly in managing or controlling another entity, or holds a share in its capital, these entities are considered related parties. The relationship may occur not only through capital but also through personal or organizational relationships.

Polish entities dealing with related entities should prepare specific tax documentation of their transactions. Such documentation can be a practical tool to use in cases where tax authorities question these transactions. These may include arguments in favor of the cooperation between the Polish company and its related entity. Above all, the tax documentation should justify the level of costs borne in relation to using related third party funds, goods or services so that the risk of the tax authorities' intervention is mitigated.

From the formal point of view, the documentation should at a minimum contain:

- Functions of the parties to the transaction;
- Total anticipated costs of the transaction, payment form and deadlines;
- Method used to calculate profits and description of the transaction's subject;
- Economic strategy used by the parties to the transaction – if it influences the transaction value;

- Benefits of the services anticipated by the party preparing the documents – in the case of intangible services;
- Other factors taken into account in the determination of the value of the transaction's subject.

It must be emphasized that if no such documentation is presented 7 days after receipt of the tax authority's request, the positive difference between the income determined by the tax authorities (based on their "independent" assessment) and that declared by the taxpayer is subject to taxation at the rate of 50% (instead of the standard 19%).

## Conclusions

Transfer pricing is a complex tax compliance issue for multinational companies worldwide. It is also very important to foreign investors running their business in Poland with supervision from abroad. With an exception for minor transactions, most of the agreements with Polish subsidiaries fall under the Polish transfer pricing regime and therefore much attention needs to be paid to this issue.

Moreover, according to the amended Polish Accounting Act, from 2009 there is a new obligation regarding related party transactions. In the Financial Statements, companies must disclose transactions concluded with related parties which do not conform to market conditions (arm's length principle). This means that a company preparing its financial statements must be aware of the transfer pricing problem and should carry out an analysis of its transactions.

Fortunately, entities operating in Poland are not left on their own with this task since all the major consulting firms have special departments dedicated to assisting with and solving transfer pricing issues (including the preparation of the transfer pricing documentation).