

September 2016

What's new in transfer pricing?

Regulatory perspective vs the experience
of businesses 2016



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1. Introduction

During the past few years, one of the most hot tax topics discussed worldwide was the lack of consistency and “leak integrity” of local regulations governing income taxes.

For tax administrations in many countries, the lack of such regulations involved the risk of multinational businesses understating and avoiding taxes, including the use of intercompany transactions for such purposes. The increased interest in this topic on the part of tax authorities and international organization manifests itself in the ongoing work of the Organization for Economic Co-operation and Development (“OECD”) and significant changes in the tax regulations in many countries following the OECD’s recommendations.

The activities undertaken on the OECD forum in 2014 as part of the BEPS (Base Erosion and Profit Shifting) Plan were aimed at identifying the key problems and risk areas and developing recommendations and solutions to enable tightening the tax systems in order to prevent tax-avoidance or understatement by businesses.

Among the 15 areas of the OECD’s work, as many as four areas related directly to transfer pricing, and were intended to:

- ensure the consistency of transfer pricing with the business substance and actual (economically justified) course of intercompany transactions relating to: (i) intangible assets, (ii) financial transactions, and (iii) high-risk transactions;
- revise the requirements for transfer pricing documentation.

Enacted regulations – MF/LF, CBCR

- 1 Australia
- 2 Spain
- 3 The Netherlands
- 4 Mexico
- 5 Poland

Enacted regulations – MF/LF

- 6 Luxembourg
- 7 Romania
- 8 Singapore

Enacted regulations – only CBCR

- 9 France
- 10 Ireland
- 11 United Kingdom
- 12 Italy

Draft regulations – MF/LF only

- 13 South Korea
- 14 Portugal
- 15 Turkey

Draft regulations – CBCR only

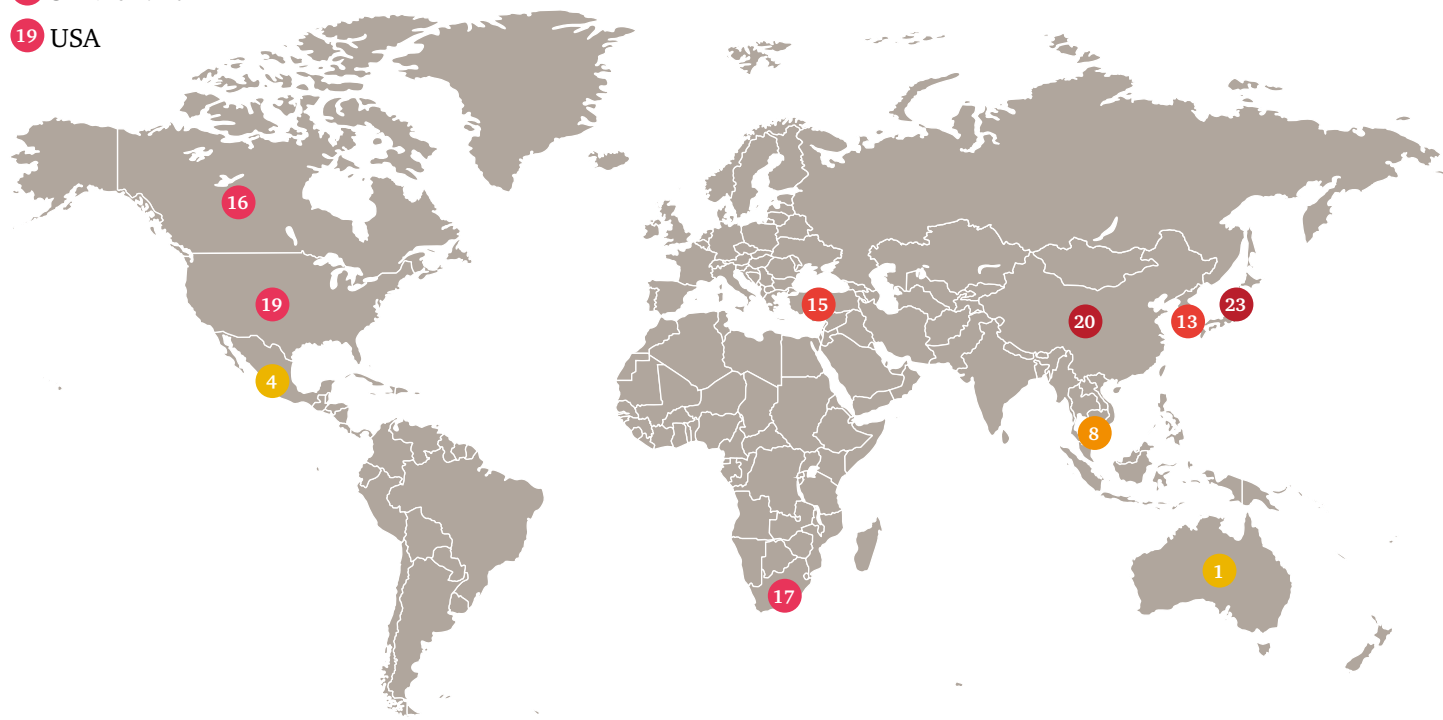
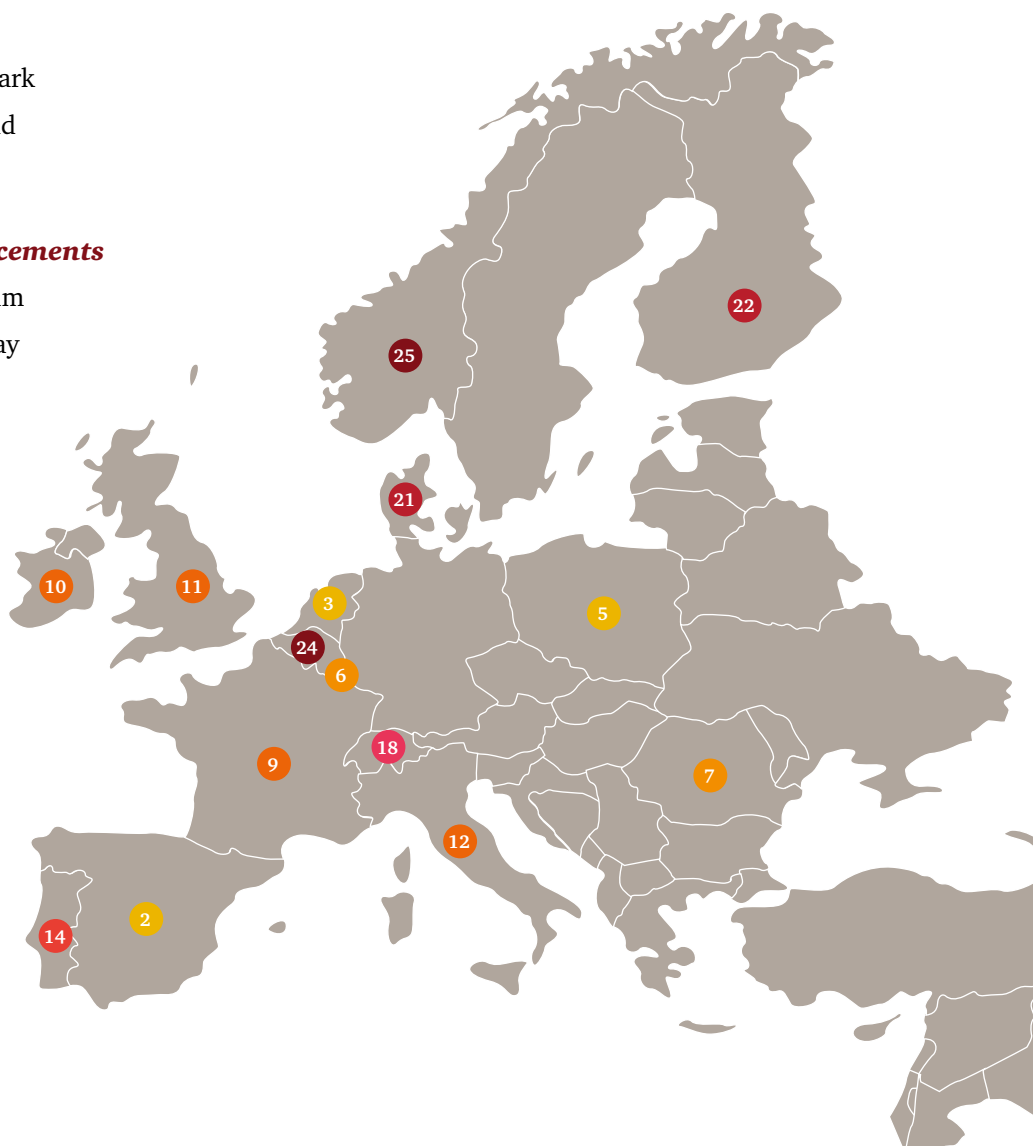
- 16 Canada
- 17 South Africa
- 18 Switzerland
- 19 USA

Draft regulations – MF/LF, CBCR

- 20 China
- 21 Denmark
- 22 Finland
- 23 Japan

Announcements

- 24 Belgium
- 25 Norway



Transfer prices are prices applied in transactions between related entities. Transfer pricing is probably the area of taxes most closely related with the economic aspects of business activities. Since transactions between related entities represent a large proportion of all business transactions, transfer pricing applied in such transactions has a decisive impact on the final profit or loss of specific group entities, and therefore, on the level of taxable income or loss declared.

In order to mitigate the risk of shifting income between countries and understating taxes, enterprises are required to determine transfer prices on an arm's length basis, i.e. at a level which would have been agreed by non-related entities.

Following the OECD recommendations, legislative changes are currently being implemented in many countries around the world and the practices of the local tax authorities and courts is also evolving.

At the same time, given the constantly high budgetary needs of governments, they are becoming increasingly interested in transfer pricing.

The Polish fiscal authorities also assigned the highest priority to transfer pricing and increased tax inspections in this area. Moreover, following the aforementioned works of the OECD, the Polish tax authorities have developed new requirements for preparing transfer pricing documentation. These changes, which may be considered revolutionary given their scale and the shifting approach of the fiscal authorities, will become effective next year.

The purpose of this report is to summarize the changes in the tax authorities' approach to tax inspections in the area of transfer pricing.

However, the key part of the report is to present the voice of entrepreneurs who shared their observations regarding the changes which are taking place. and the planned activities aimed at preparing companies for tax inspections in the area of transfer pricing, with PwC in an anonymous survey.

Piotr Wiewiórka
Partner

Monika Laskowska
Partner

2. What do tax inspections of transfer pricing look like today?

2.1. How is the approach of Polish tax authorities to tax inspections evolving?

For several years now, the tax authorities have been planning to focus on transfer pricing.

Settlements between related entities have for a few years now been indicated as one of the key areas of potential abuses and every year have been included in the national action plans for tax administration developed by the Ministry of Finance (“MoF”). These action plans form guidelines covering the areas of tax settlements which will be subjected to detailed scrutiny by the tax authorities.

Official announcements:

Transfer pricing – MoF activities to date and intentions for the future

Published: 2016/02/05 09:24

On 18 December 2015, the MoF announced that the examination of transfer pricing will be one of its priorities in 2016. In its announcement, the MoF encourages taxpayers to submit corrected tax returns for the past years by the end of Q1 2016. In the first quarter of 2016, the MoF will focus on developing its human resources and deepening their knowledge of transfer pricing issues. In the second quarter of 2016, on the other hand, tax inspections will be conducted, focusing on entities which have not paid any CIT in the prior years in spite of a significant revenue growth, which seems to suggest a structure designed with the aim of reducing the tax base in Poland to zero.

Statements made at meetings of the Polish Parliament

Meeting no. 21 on 27/06/2016 (2nd day of the proceedings)

Item 13 of the Agenda:

The second action is controlling the application of transfer prices. In the first half of this year, 170 inspections were initiated – which is significantly more than in prior years – and analytical operations are being conducted with respect to 230 entities. We will certainly start inspecting a vast majority of these entities this year. This is approximately 400 inspections in total, which is significantly more than in the prior years. We have designated people to new positions – more than 20 new jobs – in the Tax Inspection Office in Warsaw – to meet these needs. This represents 1/5 of the headcount maintained for many years in Poland as a whole. We have also increased the number of positions in other tax inspection offices in Poland. We will carry out inspections of large companies.

Warsaw, July 2015
Republic of Poland
Ministry of Finance

KS3.054.12.2015

The MoF has emphasized many times that in-depth inspections of related entities must be conducted, especially taxpayers with the highest turnover and entities with foreign capital. In this context, the MoF mentioned the practice of transferring income abroad in order to avoid taxes, including by breaching transfer pricing regulations. In this respect, the MoF perceived risks particularly in intangible transactions (e.g. involving services or licences), financial transactions and restructuring of operations.

However, until recently, the implementation of these guidelines by the tax authorities has left much to be desired. The MoF’s plans often remained on paper, because when planning their inspections, the tax offices focused mainly on combating VAT irregularities, where they believed the likelihood of success was the highest. Currently, tightened inspections of transfer pricing have become a fact. This change of approach was due to, among other things, a critical report by the Supreme Audit Office (Najwyższa Izba Kontroli, “NIK”), issued after NIK had conducted an audit of the supervision by tax authorities and tax inspection offices of the correctness of settlements with the State budget on the part of entities with foreign capital.

2.1.1. NIK report on transfer pricing inspections

In recent years, both the MoF and the NIK (Supreme Audit Office) have conducted a number of inspections to verify whether transfer pricing is indeed treated with due care.

The latest NIK inspection was conducted in the period from 1 September 2014 to 12 January 2015 in selected tax offices and tax inspection offices (“UKS”). It was aimed at examining the state of preparedness of the Polish authorities for the control of the settlements of Group entities with the State Budget.

The NIK analysis was focused mainly on settlements made by companies with foreign capital, because in their case the risk of loss of proceeds to the State Budget was considered to be the highest (due to the possibility of exploiting loopholes in international regulations and transfers of profits abroad).

According to data from the NIK, entities with foreign capital represent 10% of the total number of CIT taxpayers registered with tax offices. Based on CIT tax returns for 2011–2013:

entities with foreign capital represented:

| | |
|---------------|---------------------------------------------------------------|
| 7,8 % | of all entities which declared revenue |
| 13,6 % | of all entities which declared losses on business activities; |
| 6,2 % | of all entities which declared income; |
| 8,9 % | of all entities which declared a tax to be paid. |

such entities declared:

| | |
|---------------|---------------------------------------------|
| 21,5 % | of the total revenue declared by taxpayers; |
| 21,3 % | of the total tax-deductible costs declared; |
| 40,2 % | of total losses; |
| 31,3 % | of total income; |
| 33,8 % | of the total tax to be paid. |

Source: Information on inspection results: Supervision of the tax authorities and tax inspection authorities over the correctness of the settlements with the State budget by entities with foreign capital, Department of Budget and Finance, NIK, 17/04/2015.

According to the above data, entities with foreign capital are, on average, much larger and more profitable than Polish entities.

In consequence, due to the scale of their operations, possible irregularities in tax settlements may result in higher-than-average losses for the State Budget.

In the report summarizing the inspection, the NIK pointed out to the ineffectiveness of the tax authorities as regards transfer pricing control.

In the NIK's opinion, the said ineffectiveness was mostly due to the insufficient technical and organizational qualifications of the control authorities' employees (including an insufficient amount of dedicated training) and the lack of effective tools for selecting entities for inspection (e.g. the lack of access to databases which make it possible to analyse and compare the financial positions of businesses).

As a result, the NIK accused the tax authorities of conducting too few inspections of entities with foreign capital, as well as of the low effectiveness of the inspections conducted in the areas of transfer pricing and other forms of tax optimization.

Furthermore, the NIK proposed undertaking the following activities in order to improve the effectiveness of the tax authorities with regards to transfer pricing control:

- developing guidelines for inspecting related entities;
- devising a methodology for selecting entities for inspection;
- providing the inspectors with tools for verifying transfer pricing;
- improving employees' qualifications in the area of transfer pricing;
- intensifying inspections of entities with foreign capital.

The tax authorities have already embarked on implementing the above activities. Changes resulting from previous MoF and NIK inspections can already be seen.



2.1.2. Transfer pricing inspections are increasingly often conducted by specialized entities

The high position of transfer pricing on the list of tasks of the Polish authorities is reflected in the fact that the coordination of all activities in this regard has been taken over directly by the MoF.



For this purpose, in 2014 a team of experts (Task Force for the Inspection of Related Entities) was established at the MoF, which included selected employees of the MoF and the UKSs in Warsaw and Łódź. The team's objective is to ensure the efficient and effective cooperation of the tax authorities in transfer pricing control.

The team is responsible for establishing the rules of analysing and assessing risk as well as defining the strategic trends in control. It conducts training courses for the tax authorities' employees in transfer pricing. It also stands behind all changes in related regulations, including designing new documentation requirements which will come into force as of 2017 (for more information, see the appendix to this report).

Moreover, as from 2014, selected UKSs began to function as competence centres for the areas which had been identified as being the most exposed to fraud. The UKS in Lublin was designated as the Competence Centre for large format stores and the UKS in Wrocław – for plants of foreign entities.

In September 2014, a Competence Centre for transfer pricing and tax optimization was established within the structure of the UKS in Warsaw, whose main task is to analyse and monitor these areas as well as provide technical assistance and coordinate inspections.

Another Competence Centre with a similar role but dedicated to supporting tax offices was established at the Tax Chamber in Łódź.

| | Related entities  | Transfer pricing  | |
|--------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Entity | Task Force for the Inspection of Related Entities at the Ministry of Finance | Competence Centre for transfer pricing and tax optimization (UKS Warsaw) | Competence Centre for transfer pricing (Tax Chamber in Łódź) |
| Tasks | <ul style="list-style-type: none"> Selecting areas for TP inspections. Compiling a Good Practice Manual on TP inspections. Indicating mechanisms most frequently used to shift income. Setting trends in legislative changes. Identifying the necessary tools and sources of information. | <ul style="list-style-type: none"> Analytical and monitoring activities at the stage of selecting for inspection and cooperating with other UKSs. Providing information to support decisions on defining the UKSs' tasks. Ensuring conducting inspections in an effective manner. Working out a methodology for inspection activities which provide assistance in conducting inspections. | <ul style="list-style-type: none"> Conducting and coordinating training in TP for the tax authorities' employees. Standardizing the methodology for conducting tax inspections and proceedings. Conducting analyses to identify and assess risks in the TP area. Defining and implementing criteria for selecting entities for TP inspections. Signalling the needs for legislative changes to the MoF. |

The qualitative change associated with the training offered to inspectors as well as the support provided by specialized entities is already discernible. The inspections conducted or supported by the competence centres are better prepared. The experiences of businesses in this regard are described in Section 2.2.

2.1.3. Who may expect a transfer pricing inspection? New selection policies

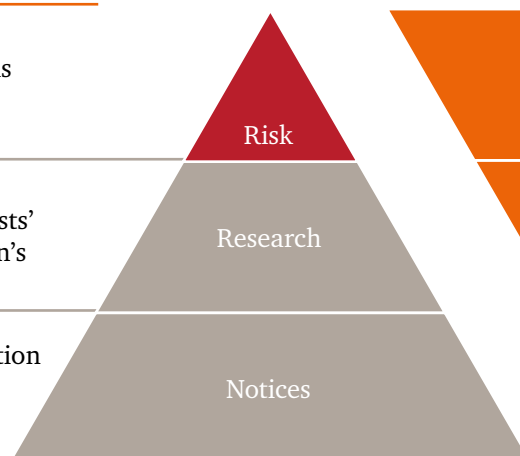
In recent years, the tax authorities have worked out a new approach to selecting businesses which will undergo a transfer pricing inspection.

Approach to date

Inspection in risk areas
– MoF guidelines

Inspection units' own conclusions
Tax analysts' and fiscal investigation's conclusions

Inspections in connection with notices from external entities

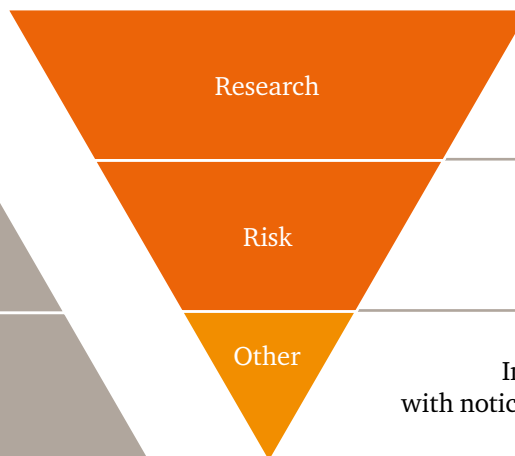


New approach

Conclusions drawn by analysts employed by the tax authorities

Number of tax inspections in risk areas
– MoF guidelines

Inspections in connection with notices from external entities



In selecting entities for inspection, the tax authorities have so far taken into consideration notifications received from individuals and legal persons as well as their own research and conclusions. They have also taken into account the guidelines received from the MoF, other tax and customs administration bodies as well as other offices and institutions (including the Police, the prosecutor's office, Internal Security Agency, and Central Anti-Corruption Bureau).¹

The tax authorities did not have any dedicated tools necessary for selecting related entities or entities which transferred income abroad. In order to pre-select businesses for inspection, they would mainly use standard, generally available sources and data warehouses used to store general tax data.

1. Information on inspection results: Supervision of the tax authorities and tax inspection authorities over the correctness of the settlements with the State Budget by entities with foreign capital, Department of Budget and Finance, NIK, 17/04/2015.

Next, the selected tax payers were further analysed, using other tools (amongst others, Serwis Prawno-Gospodarczy [Legal and Business Service], REGON [statistical business identification number]), source documents (e.g. Notarial Deeds, the tax authorities' and tax inspection decisions), generally available sources of information (the press, Internet, administrative courts' decisions and interpretations of the tax regulations) and financial statements.¹

In addition, the tax authorities (in particular the UKSs) had very limited access to a commercial database (the Amadeus database)² which offered the possibility of comparing the results of operations of businesses (the so-called benchmark study).

It constitutes a basic examination aimed at verifying the arm's length nature of settlements and, consequently, it enables them to be questioned (if need be). The UKS employees were only allowed to use the Amadeus database exclusively in the MoF building, in the presence of authorized staff, having previously agreed a mutually convenient date.

In addition, they were only able to request a set of relevant data via the technical departments of the MoF.⁴ In consequence, the tool which made it possible to obtain the data necessary for any discussion about the arm's length nature of settlements was used sporadically. Therefore, the arm's length nature of prices was seldom questioned during inspections. (According to the NIK report, data taken from the Amadeus database was used by the UKS in Warsaw in eight proceedings, as well as in 2014 in selecting entities for inspection as part of the Competence Centre's work on transfer pricing, shifting income and optimization).

2. Ibid

3. The Amadeus is an independent commercial database which contains financial information about approximately 3 million European entities. The Amadeus database contains breakdowns of data collected from entities which operate in all European countries.

4. Information on inspection results, *ibid*.

New approach

At present, taxpayers are selected for a transfer pricing inspection in a different manner. In the first place, the conclusions drawn by the analysts employed in the competence centres (rather than – as was the case – in individual tax offices) are taken into account, which makes it possible to undertake coherent, coordinated and more target-oriented activities. Such conclusions are prepared based on the MoF guidelines and industry-specific analyses.

In this way, the tax authorities ensure that inspections will indeed be carried out in line with the adopted priorities, in the areas which have been recognized as being particularly exposed to fraud. Moreover, in this way they can take a more comprehensive look at the industries which are of interest to them, compare the businesses which operate in them, and select those whose results deviate from market standards.

| Risky industries | Main risk areas according to the OECD | Main risk areas according to the NIK |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> - advisory and other intangible services; - other wholesale trade; - real estate; - activities of sales agents; - manufacture of building materials and construction services; - financial and insurance services; - trading in electronics; - e-trade and IT services; - manufacture and trading in metals and metal products; - automotive industry; - trading in foodstuffs and tobacco; - fuels; - transport and logistics; - health care. | <ul style="list-style-type: none"> - material transactions with entities located in tax havens; - transfer of intangible assets to a related entity; - change of operating model and restructuring; - specific types of transactions and payments; - an operating loss; - low operating profits; - a low effective tax rate; - incomplete documentation or no documentation; - excessive debt. | <ul style="list-style-type: none"> - using double taxation treaties for aggressive tax optimizations; - transfer pricing, in particular that relating to intangible services and goods; - restructurings of operations; - provision of intra-Group services; - mutual financing of related entities. |

*National Plan of State Administration Activities 2016. (The breakdown contains all listed industries without dividing them by offices which should inspect them.)

At this point, it should be emphasized that the tax authorities have already equipped themselves with some new tools which allow them to conduct such analyses. At present, they already have access to the said commercial Amadeus database which makes it possible to analyse and compare data taken from the financial statements of individual businesses.⁵

Therefore, it can be expected that selecting businesses for inspection will be more accurate, and that the tax offices will commonly use the database during their inspections in order to verify whether taxpayers make their settlements on an arm's length basis.

5. According to the NIK report, the purchase of a tool containing data necessary for performing a financial analysis of businesses was planned for two competence centres – the UKSs in Warsaw and Łódź, six specialized tax offices, and the Centre for Analyses and Planning of the Tax Administration in Wrocław.

Example:

In order to present the tax authorities' possible approach to selecting taxpayers for inspection in a more visual (yet largely simplified) manner, we collected some data from the Amadeus database (the very database any tax office could use) for companies operating in an industry which is on the list of "risky industries" (presented above). Next, using the risk factors indicated by the tax authorities, we took a look at the results we had obtained.

Our conclusions are presented below (we would like to emphasize that this example illustrates our conjectures only and is aimed at presenting the problem in a visual manner.)

| Independence index* | EBIT (PLN'000) | | | | Profitability (operating margin) | | | | |
|---------------------|----------------|---------------|---------------|---------------|----------------------------------|----------------|---------------|---------------|-------------------|
| | 2014 | 2013 | 2012 | 2011 | 2014 | 2013 | 2012 | 2011 | Average 2014-2011 |
| D | 227 101 | 193 282 | 149 931 | 160 998 | 5,7 % | 5,5 % | 5,0 % | 5,8 % | 5,5 % |
| B+ | 31 905 | 33 820 | n.a. | 26 907 | 2,6 % | 2,5 % | - | 3,0 % | 2,7 % |
| B+ | 47 548 | 41 674 | 24 022 | 30 664 | 6,7 % | 6,4 % | 4,7 % | 6,3 % | 6,1 % |
| B+ | 11 866 | 16 295 | 8 825 | 20 260 | 3,1 % | 4,2 % | 2,5 % | 5,9 % | 3,9 % |
| B+ | 6 264 | 3 320 | -204 | 4 079 | 1,8 % | 1,2 % | -0,1 % | 2,3 % | 1,3 % |
| A+ | 4 111 | 4 237 | -1 143 | 6 152 | 1,3 % | 1,6 % | -0,6 % | 3,6 % | 1,4 % |
| D | 7 193 | 4 793 | 4 793 | 9 476 | 2,3 % | 2,0 % | 2,0 % | 3,5 % | 2,5 % |
| B+ | 6 367 | 5 977 | 5 275 | 4 871 | 2,2 % | 2,7 % | 3,6 % | 3,8 % | 2,9 % |
| D | n.a. | -5 598 | -3 205 | -2 265 | - | -16,9 % | -9,8 % | -6,8 % | -11,2 % |

* D stands for related entities (i.e. one shareholder holds more than 50% of shares in this company)

For our analysis, we selected the data of companies operating in one of the "risky industries", i.e. the automotive industry. Based on the results of operations of the individual companies in recent years, we selected entities which belonged to groups of companies that might possibly attract the inspectors' attention.

They were companies whose results deviated significantly from the market standard – in particular those which had been incurring losses for many years and whose profitability was negative. We marked the example of such company in the above table.

A company which has been incurring losses for many years and whose profitability is much lower than the average profitability on the market that is achieved by independent entities.

2.1.4. Tax authorities have already announced success

This year, transfer pricing inspections continue to be a priority task of the tax administration which is intended by the MoF to counteract shifting profits abroad and to increase budgetary receipts.

A marked intensification of activities can be seen in this respect.

In 2016, the MoF's extensive activities started with an announcement which encouraged businesses to voluntarily correct their tax returns. Intensifying tax inspection was the next step.

The number of instituted proceedings relating to the correctness of transfer pricing increased visibly. In addition to quantitative changes, it is symptomatic that the application of transfer pricing regulation was extended to other areas, previously not inspected (e.g. benchmark study methodology, verification of a functional analysis for compliance with contracts or the data presented on a website). Consequently, tax inspections have become more comprehensive as well as more focused on selected (material in terms of their value) areas of a company's operations.

At the beginning of the year, the MoF summarized the activities of the tax administration in the area of tax inspections conducted at the turn of 2015 and 2016.⁶ The summary also presented examples of the outcome of tax inspections in the area of transfer pricing which resulted in adjustments of income and tax.

⁶ Transfer pricing – activities to date and the MoF intentions, Ministry of Finance, 05/02/2016.

Below we present examples of tax inspections made public by the MoF:



| Scope of irregularities | Inspection outcome |
|-----------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------|
| Selling shares in chain transactions between related entities | PLN 500 million – understatement of CIT liability for one year |
| Conclusion of a single contract with a foreign entity which resulted in reporting a significant loss | PLN 300 million – challenging a tax loss |
| Domestic entity paying a licence fee to a foreign entity at a level not consistent with the market practice | PLN 25 million – adjustment of tax-deductible costs for 4 tax years |
| Application of an incorrect key for the allocation of costs and profits between a foreign head office and the Polish branch | PLN 2 million – additional assessment of CIT |
| Granting loans or guarantees between related entities on terms more favourable than the prevailing market terms | PLN 7 million – additional assessment of CIT |

The MoF's action plan for the next few months includes expanding and strengthening human resources as well and intensifying the tax inspections of selected taxpayers, particularly companies with foreign capital.

As indicated by Deputy Minister of Finance, Konrad Raczkowski, in his interview for the Puls Biznesu⁷ daily, the tax authorities “intend to increase the efficiency of tax inspections which will be conducted with the support of an additional 60,000 officers from other departments of the Ministry, rather than only 5,000 employees of the Tax Inspection Offices.”

As a result, they plan to improve tax collection which should bring PLN 15 billion of additional budgetary receipts next year. The major part of this amount is expected to be generated as a result of transfer pricing inspections.

7. Puls Biznesu, Raczkowski: We will fix the tax system, 04/02/2016.

2.2. Do they still keep threatening, and really nothing changes? Taxpayer's perspective

The experience of enterprises which participated in PwC's survey confirm the changing attitude of the tax authorities to transfer pricing inspections.

PwC survey

In May 2016, PwC conducted a survey addressed to Polish companies which belong to capital groups. One hundred and thirty-eight companies participated in the survey. They included members of both Polish and international groups and represented different levels of turnover (the analysis was conducted with respect to 3 groups:

- up to EUR 10 million;
- from 10 to 50 EUR million;
- up to EUR 50 million).

The survey was anonymous.

The survey was not a statistical survey.

The survey included a number of questions relating to:

- preparation of the documents required by the Polish transfer pricing regulations;
- experience from inspections of transfer pricing and
- current and planned activities aimed at preparing for new documentation requirements.

Responses of the survey participants, together with PwC comments, are presented below.



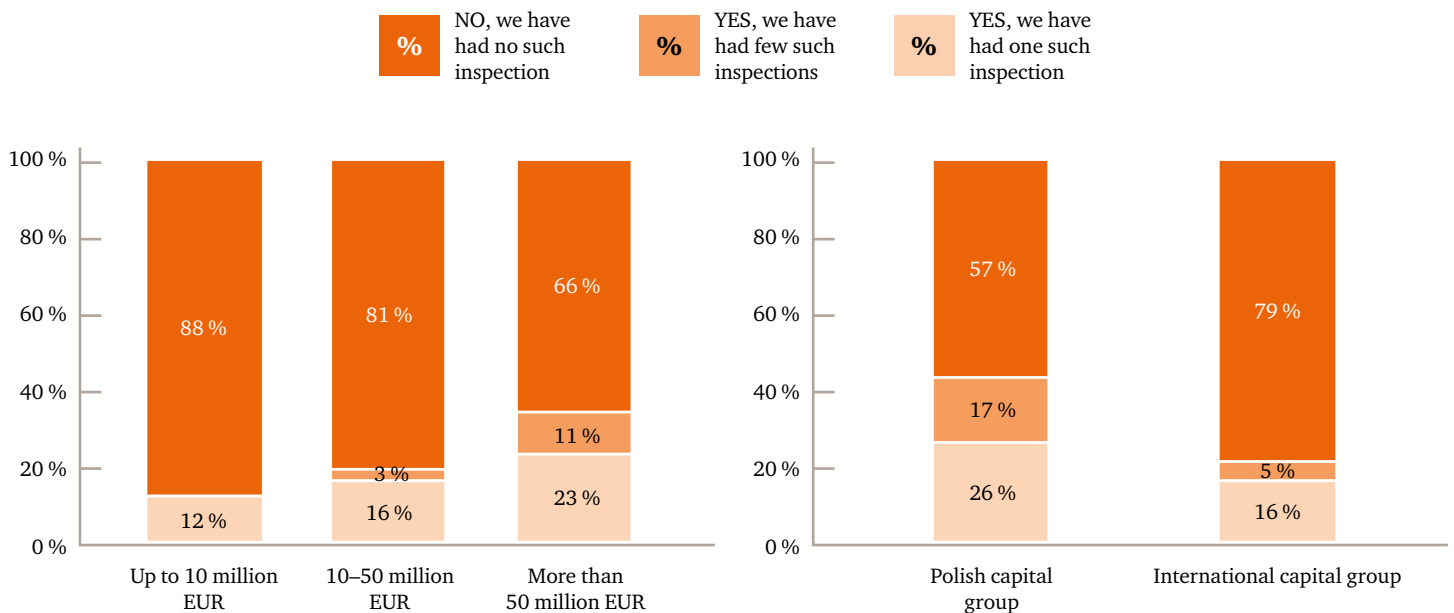
2.2.1. Who was inspected?

As many as 26% of the survey participants have had a tax inspection relating to transfer pricing in the past few years.

Approximately 8% of enterprises had more than one such inspection.

Tax inspectors usually scrutinized the largest enterprises with a turnover of more than EUR 50 million – as many as 34% of those had at least one inspection in recent years.

Have your company had a transfer pricing inspection in recent years?



Interestingly, companies belonging to Polish groups were inspected far more often – 43% of such companies have had transfer pricing inspections. Such inspections were conducted in only 21% of the companies with foreign capital.

On the other hand, such profiling of the inspected entities may be evidence of the tax authorities expecting domestic groups to be using the same tax management tools as foreign ones, and consequently, seeking to verify if this is done in compliance with the applicable law.

According to PwC:

Taking into account the objectives of transfer pricing inspections as defined by the MoF (i.e. preventing profit shifting in multinational enterprises), it should be expected that in the near future, the tax inspection offices will focus on entities with foreign capital. Tax inspections in such enterprises have repeatedly been indicated as the key priority for the inspectors, including by the NIK and the MoF.

While similar announcements have been made for many years now, it seems that this time they should not be ignored. For the first time, tax authorities have the capabilities needed to conduct such inspections, due to gaining access to the relevant tools, the improved competencies of tax inspectors, and access to a wide range of information which will need to be disclosed under the new documentation requirements developed as a result of the BEPS work by the OECD (for more information, see Appendix.)



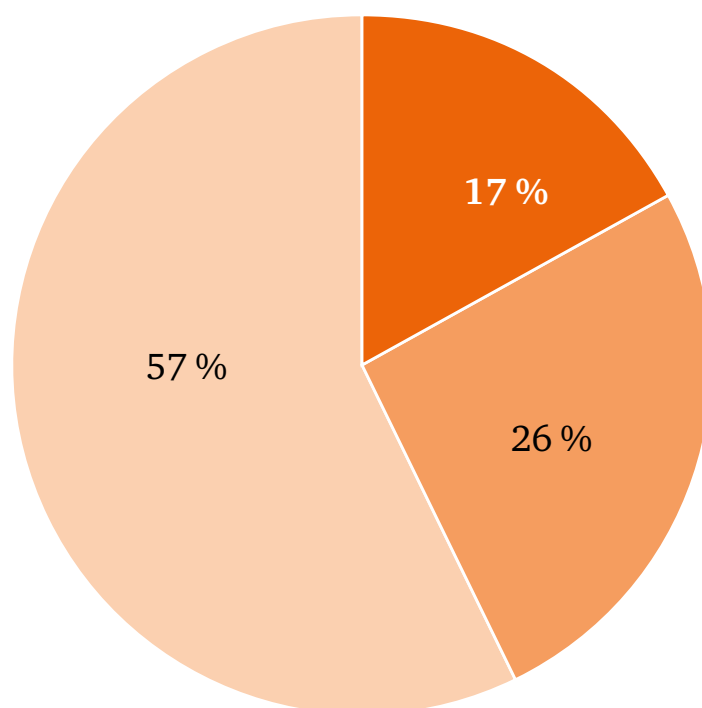
2.2.2. Which tax administration units were the most active in conducting transfer pricing inspections?

The companies surveyed confirmed that the majority of inspections addressing transfer pricing issues were conducted by UKSs (Tax Inspection Offices).

Among all companies which have had a transfer pricing inspection, as many as 74% indicated that the inspections were conducted by UKSs (including approximately 17% of businesses which were also inspected by tax offices). UKSs were the most active, irrespective of the size or the inspected entity or its capital.

Which body conducted the inspection?

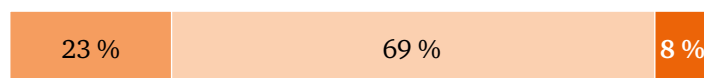
% Tax Office (US)
 % Tax Inspection Office (UKS)
 % US i UKS



More than 50 million EUR



International capital group



Up to 50 million EUR



Polish capital group

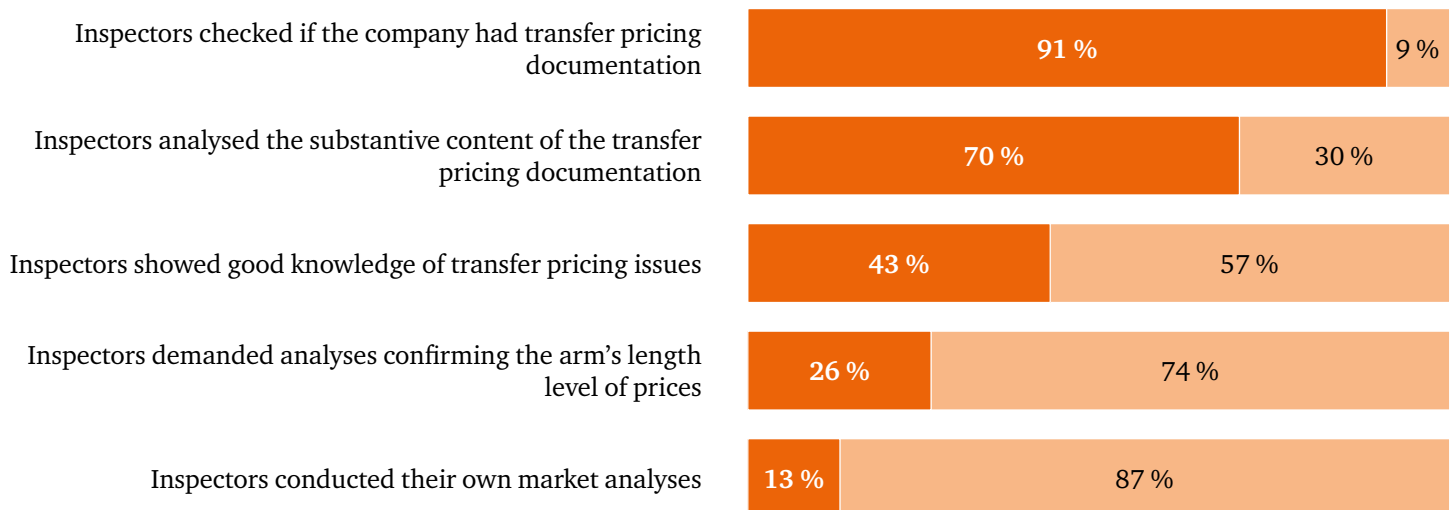


2.2.3. Is the quality of the inspections really improving?

In principle, respondents who shared their observations on transfer pricing inspections conducted in their companies with PwC have noticed improved competencies of the tax inspectors. Approximately 41% of the businesses inspected confirmed a substantive improvement in tax inspections. The respondents also confirmed that the inspections have become more detailed – 42% agreed with this statement.

What is your experience of a transfer pricing inspection?

% YES **%** NO



The first question and most frequently asked by tax inspectors reviewing the area of transfer pricing is that of having transfer pricing documentation covering the period under review. As many as 91% respondents were asked this question.

The demand to present documentation may be expected during any tax inspection, irrespective of the increased competencies of the inspectors. It has now become routine. The documentation gives the inspectors a very clear view of the most important and largest, in terms of value, transactions concluded by a company. It is therefore a good starting point for asking further questions and performing a more detailed inspection.

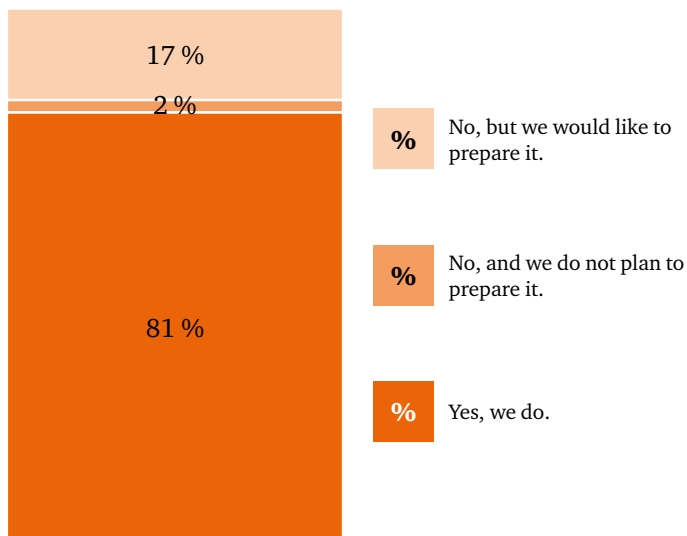
Moreover, one should not forget that checking the existence and completeness of the documentation may prove effective from the point of view of the fiscal authorities and may increase budgetary receipts. This is because in the case of missing or incomplete documentation, a taxpayer faces the risk of having a penalty CIT rate of 50% applied to any understated income identified by the tax authorities.

Properly prepared documentation is the basic measure to mitigate this risk. At the same time, taking into account the currently applicable regulations, it is a fairly standardized report and easy to prepare. It is therefore all the more surprising that a significant proportion of businesses have not yet prepared the said documents.

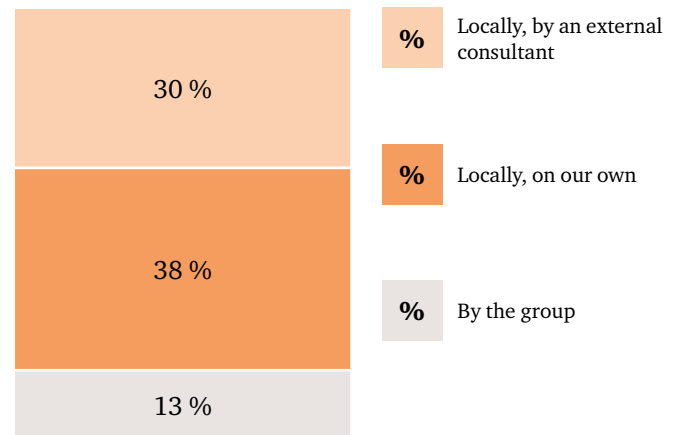
The PwC survey showed that as many as 19% of the businesses surveyed have not yet prepared transfer pricing documentation.

Moreover, approximately 13% of businesses only has the documentation prepared by their group. Such documentation may be used by a taxpayer, provided that it contains all the elements specified in the Polish regulations. Unfortunately, this is not always the case. Transfer pricing documentation prepared by head office companies is usually based solely on OECD guidelines (and sometimes on the local regulations of the parent company), so that it is consistent and useful for the maximum number of group companies. Given the specific approach and requirements applicable to documentation in Poland, without prior amendments following in line with Polish legal regulations, group documentation is usually not correct and complete transfer pricing documentation. Therefore, taking into account the simplest obligation, i.e. having complete transfer pricing documentation, the preparedness of a further 13% of taxpayers is in question today.

Do you have transfer pricing documentation?



Your transfer pricing documentation has been prepared:



If group transfer pricing documentation is to serve as the local Polish transfer pricing documentation, the following must be ensured:

- the documentation contains all the elements specified in the Polish regulations;
- the documentation contains a separate analysis of each transaction which is subject to documentation requirement in Poland;
- the documentation has been translated into Polish.

As a result of the current practice, tax inspectors have accustomed taxpayers that an inspection which covers transfer pricing issues typically ends with the question of whether or not the taxpayer has transfer pricing documentation. However, such an approach is quickly changing, as noted by the respondents in the PwC survey. It shows that in 70% of the inspections analysed, the inspectors also reviewed the substantive content of the documentation. More in-depth analyses of the inspectors resulted in further, more detailed questions asked to understand a taxpayer's operations and to identify potential inconsistencies in the materials provided.

The survey also showed that the inspectors started to look more carefully at the level of intra-group settlements and to verify their arm's length character by conducting own benchmark analyses.

While currently Polish taxpayers are not required to prepare benchmark analyses, as many as 26% of the respondents admitted that the inspectors asked them for such studies during their inspections.

Moreover, in 13% of the cases, tax inspectors conducted their own benchmark studies in order to verify the arm's length nature of settlements. This shows that they are already using their new tools.

In accordance with the currently applicable regulations, it is not mandatory (but recommended) for Polish taxpayers to prepare benchmark analyses. However, if a taxpayer shows such a study during an inspection, the study will likely be analysed (since the inspectors now have the necessary tools). For the results of the benchmark study to be taken into account, the document must meet the criteria preferred by the Polish authorities. In principle, these criteria are consistent with OECD recommendations and international practices. Nevertheless, they include a number of characteristics, such as the method for selecting entities which may be considered market peers.

According to PwC practice:

Our experience shows that there is a strong preference for benchmark studies prepared based on the financial data of the companies operating in Poland. If a taxpayer has a benchmark study which has been prepared based on international (regional/global) data, it may be expected that the inspectors will first look for the data on Polish companies and will use only such data to verify the arm's length nature of the taxpayer's settlements. If the inspectors do not find such data, but believe the data is available (e.g. by performing own benchmark study), they may reject the results presented in the document provided.

It should also be mentioned that the Polish tax authorities have already formalized their preferences for benchmark studies, and it will be mandatory for certain taxpayers to prepare a benchmark analyses under the new documentation requirements which enter into force in 2017. It will be required to prepare benchmark studies on the basis of Polish data. Expanding the scope of analysis to international data will only be possible if finding comparable companies on the Polish market proves impossible. Given the fact that benchmark studies will soon become mandatory, and are already often analysed during inspections, let us have a look at the degree of preparedness of Polish businesses in this area.



The PwC survey shows that 56% of businesses have not prepared any benchmark analyses so far, and a further 22% only have such analyses prepared based on global/regional data which may not comply with the Polish requirements. Therefore, it seems that Polish businesses still have a lot to do.

In addition, it should be emphasized once more that both the capabilities and willingness of the tax office to engage in a technical discussion on benchmark studies have recently increased significantly. The tax authorities not only challenge the methodologies applied in preparing benchmark analyses, but also prepare their own studies. Below we present examples of actual charges raised by the tax inspector encountered in our practice.

Examples from tax inspections

A company conducts distribution activities and belongs to an international group. The company had a benchmark study prepared by the group for the global market, but included a sub-sample for Europe. The model of settlements adopted by the group ensured the profitability of the Polish company at a market level determined based on the said study.

During an inspection, inspectors questioned the correctness of the benchmark study presented. They considered, e.g. that the study had not been prepared using solely comparable data, i.e. the data relating to the Polish market, and that the number of Polish companies in the European sample was too small. The inspectors concluded that even if it was really impossible to find the Polish data, comparable data include companies operating in Central and Eastern Europe only, rather than in the whole of Europe.

As a next step, the inspectors prepared their own study. They used Polish data only, and the sample was made sufficient, in their opinion, by taking a very broad approach to defining the scope of a company's operations. This was determined based on classification codes specified in the company's entry in the Register of Businesses and on the company's website (which did not describe in detail the functions performed by the company, but rather presented its sales offer). In an attempt to justify such an expanded approach, the inspectors e.g. verified the number of employees and the roles performed by them.

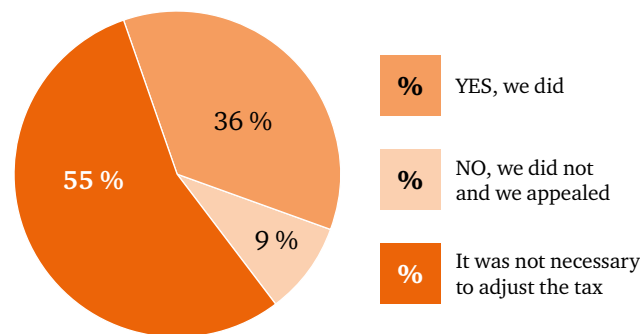
The inspection ended in an additional tax assessment.

2.2.4. What was the subject of transfer pricing inspections and how effective were these inspections?

The results of the survey conducted by PwC confirm increased activity and effectiveness of the tax authorities as regards transfer pricing inspections.

In 45% of the inspections conducted in the companies of the survey respondents, the tax office assessed additional tax. Note that 36% of such inspections ended with an adjustment of tax.

Did the Company adjust its tax as a result of the inspection conducted?



The areas which were inspected most often and challenged by the tax authorities in principle coincided with the NIK's guidelines. In accordance with the results of the survey conducted by PwC, additional tax was assessed most often in the following areas:

| Risk area | % of additional assessments reported by the businesses surveyed |
|------------------------------------------------------------------|-----------------------------------------------------------------|
| Free-of-charge benefits | 23 % |
| Level of prices in service transactions | 14 % |
| Level of prices in transactions involving intangible assets | 14 % |
| Level of prices in transactions involving goods | 14 % |
| Level of prices in financial transactions (guarantees and loans) | 14 % |

Therefore, all seems to indicate that this time, the tax authorities are consistently implementing their plans. They are increasing the number of inspections and improving their quality. At the same time, they stick to the priorities agreed.

3. What is in store for us and how to deal with the new obligations?

The amended PIT and CIT Acts have introduced a number of new requirements relating to preparing transfer pricing documentation. In accordance with the new regulations, some of the taxpayers entering into transactions with related parties will need to prepare much more extensive documentation. On the other hand, the new regulations will make life easier for taxpayers operating on a micro scale who enter into transactions with related parties.

Below we present a short summary of the changes for which one has to prepare (for a more detailed description, see the Appendix). We also present the current level of preparedness of Polish businesses.

3.1. Which obligations will need to be met?

In accordance with the new Polish regulations, the scope of documentation requirements imposed on a taxpayer will depend on the scale of the taxpayer's activity, i.e. on the level of revenue earned / costs incurred.

Preparation of the documentation will be required of taxpayers whose revenue / costs for the prior year exceeded EUR 2 million.⁸ The requirements for such taxpayers will be similar to those currently applicable: it will be necessary to prepare local documentation for transactions which exceed the statutory thresholds and to submit a declaration that such documentation has been prepared to the tax office.

Changes in transfer pricing documentation – mandatory components

| | | |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------|
| <p>1 Local file Detailed information on specific transactions. Justification for the arm's length nature of prices is not required (benchmark studies are not mandatory).</p> | <p>1 Local file Detailed information on specific transactions (including benchmark studies which are mandatory when revenues/costs > EUR 10 million).</p> | <p>Revenues / expenses > EUR 2 million</p> |
| | <p>2 Declaration Declaration that tax documentation has been prepared, submitted together with a tax return.</p> | <p>> EUR 2 million</p> |
| | <p>3 CIT-TP declaration A report (information on a taxpayer and the transactions concluded) submitted together with the tax return.</p> | <p>> EUR 10 million</p> |
| | <p>4 Master file Description of business activities and the operating model of the group.</p> | <p>> EUR 20 million</p> |
| | <p>5 Country by Country Report (CbCR) Aggregated information on the allocation of income and taxes paid by the group in specific jurisdictions</p> | <p>consolidated group revenues > EUR 750 million</p> |

Current requirements applicable in Poland

New requirements

8. Smaller businesses will not be obliged to prepare documentation, unless they (i) concluded transactions with tax havens; (ii) concluded a partnership agreement, or (iii) conduct a joint venture.

As the scale of a taxpayer's operations increases, further documents will be required. These are:

- CIT-TP declaration
- Master file
- Country by Country Report (CbCR)

Moreover, in the case of taxpayers whose revenues or costs exceeded EUR 10 million in the prior year, documentation will need to include an analysis of comparable company data (a benchmark study) which takes into account Polish entities conducting comparable activities, if available. The analysis will have to be prepared for individual transactions (rather than the entire business activity of a taxpayer).

New regulations on transfer pricing documentation will become effective on 1 January 2017 and will apply to transactions and events occurring after that date. The only exception are the requirements for country-by-country reporting which entered into force on 1 January 2016.



3.2. What will the new regulations mean for a taxpayer?

The introduction of the new regulations will:

- involve an increased amount of work on the part of a taxpayer to prepare documentation: entities will be obliged to prepare additional documents (a declaration, a master file, CIT TP, CbCR) and a local file with an expanded scope. On the other hand, some of the obligations will be reduced;
- provide additional tools for an assessment of the risk of infringements to the tax authorities (CbCR, CIT TP);
- result in the need for a company to disclose a significant amount of information and increase the risk of revealing inconsistencies (e.g. in the case of inconsistency between the data included in the local file with the data in the financial statements);
- shift to the taxpayer the burden of proof that the transfer prices applied have been set on an arm's length basis.

3.3. How are businesses preparing for the new obligations? Conclusions from the survey conducted by PwC

Many taxpayers noted the expanded documentation obligations. Some of them decided to take some steps to prepare before the new regulations become effective.

3.3.1. Which documents are already being prepared by groups?

The survey conducted by PwC⁹ showed that preparatory steps taken by businesses have a very varied scope. They may include both selected elements of the documentation and, more and more often in the case of large taxpayers (or even the entire groups), a full review of transfer pricing issues in order to identify and mitigate risks early, combined with preparing full-scope documentation in its new format.

What steps are undertaken in your group in connection with the change in the global approach to documenting transfer prices (new guidelines of the OECD):

International capital group*



Polish capital group



* % of businesses in a given category which selected a given answer (multiple answers were possible; percentages do not add up to 100%).

In particular, differences may be noted in the approach to preparations between Polish and international groups.

9. A description of the survey is presented in section 2.2.

Steps already taken by international groups have typically included preparing a master file – 48% of the surveyed companies with foreign capital already have a master file. (As mentioned above, the master file is a novelty in the Polish documentation requirements. Preparation of the master file will become mandatory with respect to the data for 2017.)

Such a large proportion of groups which already have master files results from the fact that master files have already been prepared for the needs of group companies abroad, usually in accordance with the principles set out in international guidelines¹⁰ rather than those specified in Polish regulations.

It should therefore be noted that a master file prepared in this way may currently not meet either the OECD guidelines¹¹ or the Polish requirements which are based on them, and should be adjusted and amended in order to be used to comply with the new documentation requirements.

On the other hand, the steps most often taken by Polish groups included adjusting guidelines for preparing local transfer pricing documentation (the local file) to the new requirements. As 44% of the Polish groups surveyed have already started to do this.

Taking into account the results presented above, it seems that in the first place, companies belonging to Polish and international groups decided to adjust those components of the documentation with which they were already familiar and which they used to prepare. They seem to have left the new components for later. What then are their plans for future action?

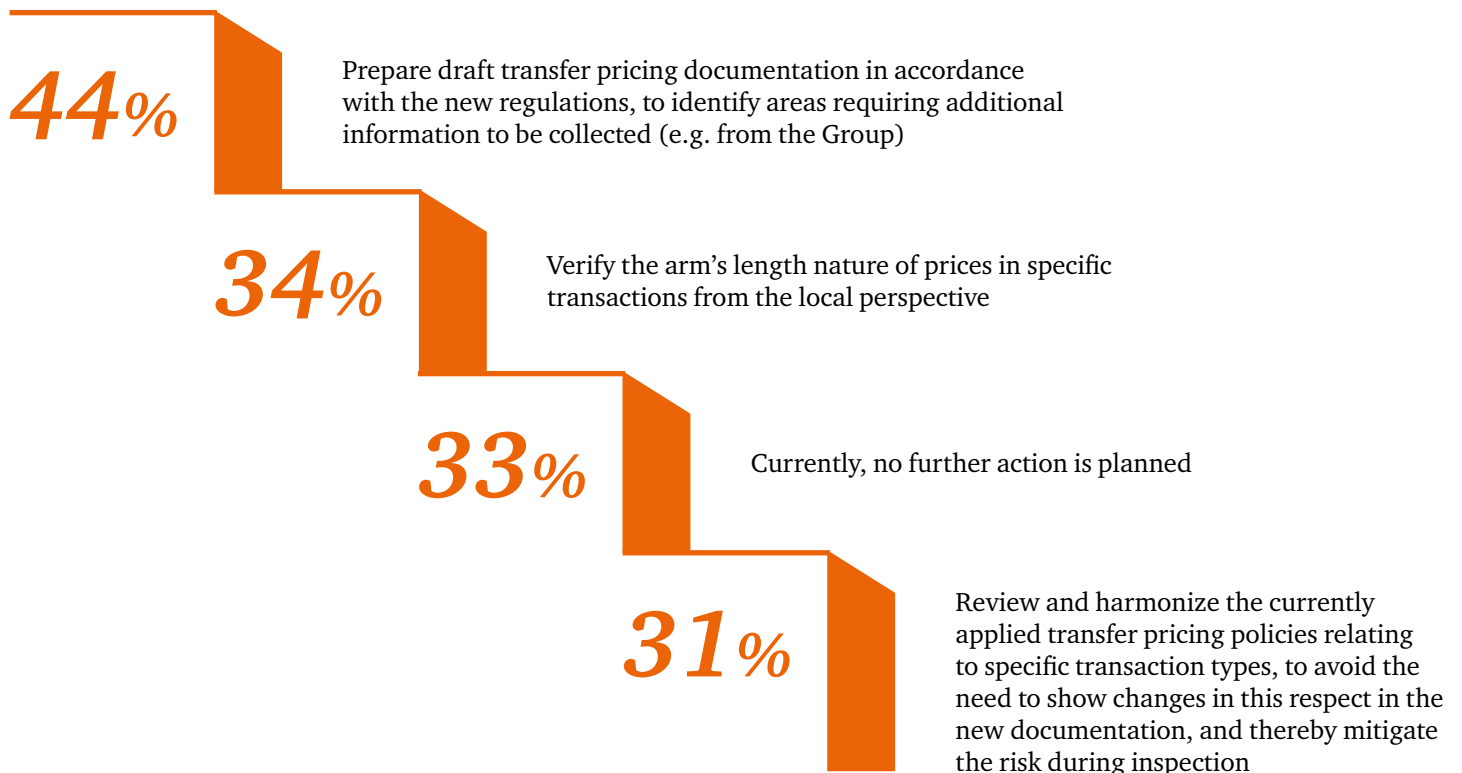
¹⁰ Guidelines on how to prepare a master file have been provided in the Resolution of the Council and of the representatives of the governments of the Member States, meeting within the Council, of 27 June 2006 on a code of conduct on transfer pricing documentation for associated enterprises in the European Union (EU TPD).

¹¹ Changes in the former approach to documentation, including a master file, have also been addressed by the OECD which proposed a new approach to the documentation and indicated which elements should be included in specific documents in the report published as part of the already mentioned BEPS initiative. These changes are currently being implemented in individual countries. The Polish regulations are also based thereon.

3.3.2. What measures entrepreneurs are planning to better prepare for the new requirements?

One of the most popular ideas for how to prepare for the new requirements is to prepare in advance preliminary versions of the tax documentation in accordance with the new requirements. This seems to be a good solution, as it enables checking in advance if a company has all the necessary information and documents and if the final outcome of the work will expose it to a risk in the area of transfer pricing. Early preparation of the documentation in accordance with the new requirements will also allow reducing the amount of work to be done in future. This may be critical especially in the case of documentation for 2017, when a strict deadline for preparing the documentation will apply for the first time.

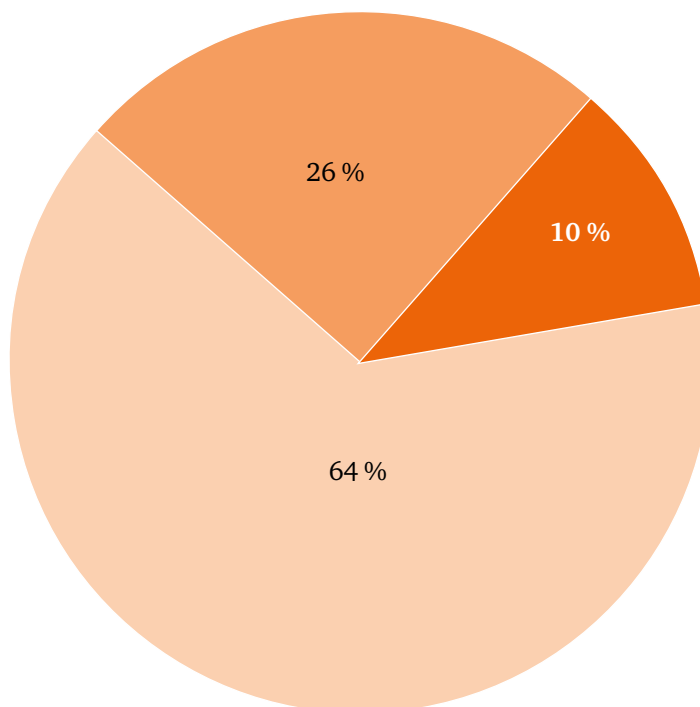
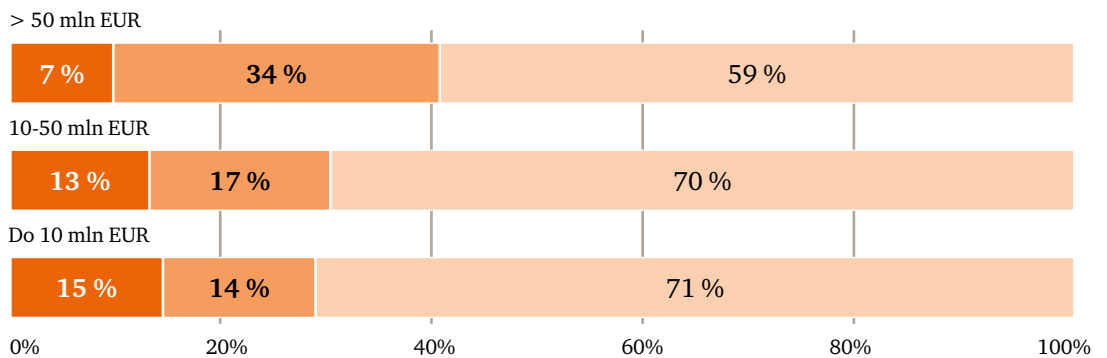
In connections with the increased transparency of the financial data and information required in transfer pricing documentation under the new regulations, do you plan to:



The survey conducted by PwC showed that as many as 44% businesses plan to prepare preliminary versions of the documentation in accordance with the new requirements. Moreover, approximately 38% of businesses are already planning to prepare the new documentation for 2015 and 2016, i.e. earlier than required. Such actions are planned or undertaken mainly by large businesses (more than EUR 50 million) which expect the most significant expansion of their documentation duties.

Is your transfer pricing documentation prepared in accordance with the new regulations?

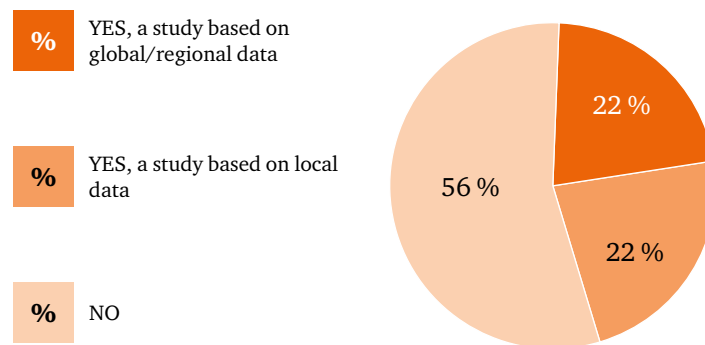
- 7 %** Yes, we are currently preparing transfer pricing documentation for 2015 in accordance with the new regulations
- 34 %** No, but we intend to prepare transfer pricing documentation for 2016 in accordance with the new regulations.
- 59 %** No, in accordance with the law, we will prepare transfer pricing documentation under the new regulations no sooner than for 2017



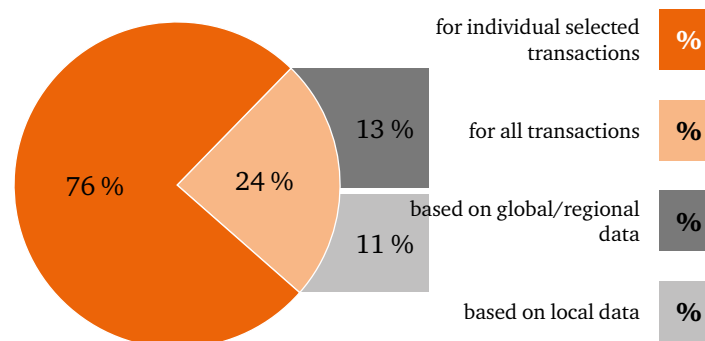
Another step taken by Polish businesses in order to prepare themselves for the new documentation requirements is to develop benchmark studies in accordance with the Polish law (i.e. based on local data). Approximately 34% of the businesses surveyed plan to prepare such studies (including 52% of the largest enterprises). However, what is the state of preparedness at the moment?

As already mentioned in previous sections of this report, according to the currently applicable regulations it is not mandatory for Polish taxpayers to prepare benchmark studies, but is, of course, recommended. Probably in connection with that, as many as 56% of businesses have not prepared any benchmark studies so far, and a further 22% only has such studies prepared based on global/regional data which may not comply with the Polish requirements (since they may not include Polish data).

Do you have benchmark studies which justify the arm's length level of the transfer prices applied?



Benchmark studies have been prepared:



Another issue which should be taken into account by a taxpayer when preparing for the new requirements is the need to justify the arm's length nature of every transaction which is subject to the documentation requirement. Currently only 11% of the companies which prepared benchmark studies based on local data have developed them for all transactions which are subject to the documentation requirement.

Consequently, the survey conducted by PwC shows that only 11% of the companies have all the necessary benchmark analyses required by the new regulations.



With this in mind, it should be remembered that preparing a benchmark study is a time-consuming task. If many transactions are to be documented, one should not postpone this task until the last moment.

Another step planned to be taken by 31% of the businesses surveyed by PwC is to review and harmonize the currently applied transfer pricing policies relating to specific transaction types. This is an activity which may significantly reduce the transfer pricing risk to which individual group companies are exposed, because it will allow verifying if a group indeed applies consistent principles of price calculation (e.g. if prices in comparable transactions with different group companies are calculated in accordance with the same principles), as well as confirming if prices in intra-group transactions are set on an arm's length basis.

It should be noted that a transfer pricing policy will be a mandatory element of the master file required by the new documentation requirements. By verifying the transfer pricing policy document, a tax office will be able to check if the settlement methods adopted in specific transactions are consistent with the practice adopted by the group. Already now (when it is not required to present the policy to tax offices) it is worth having a look at the settlement methods applied within the group, to try to summarize and verify these methods and to correct those which will give non-arm's length results. An early analysis and adjustment of the currently applied transfer pricing policies will enable companies to avoid the need to show changes in this respect in the new documentation, and therefore to mitigate the risk during inspection.

To learn more about how to prepare to new documentation obligations, please visit our website: www.pwc.pl/cenytransferowe

4. Summary

In recent years, the perspective from which transfer pricing is perceived by tax administration in the majority of jurisdictions, including Poland, has changed significantly.

Prevention of tax avoidance through the use of transfer pricing has become a priority for tax administrations in more than 100 countries worldwide. Consequently, in cooperation with international organizations (OECD, G7, World Bank, EU, ATAF), recommendations and instruments were developed to improve the effectiveness of tax administrations in counteracting tax avoidance and to increase the transparency of international groups vis-à-vis tax administrations in all countries where such groups operate.

The instruments proposed and recommendations made are international in their character, for example:

- improving international cooperation as regards joint inspections of transfer pricing (conducting simultaneous inspections or joint audits by the tax authorities of different tax jurisdictions);
- improving the exchange of information (including the obligation of tax administrations in various countries to automatically exchange information) in order to more effectively identify entities which avoid taxes by using transfer pricing (e.g. CbCR reporting, exchange of master files).

In addition, we have observed that experts from different areas of transfer pricing in tax administrations of various countries have strengthened cooperation with customs authorities to analyse the consistency of settlements in these two areas. Regional cooperation between tax inspection services of the countries in a given region has also been strengthened.

In addition, recommendations and instruments developed by international fora form a basis for legislative changes to be implemented in national tax systems. In the area of transfer pricing, Poland has used in practice all the proposed legislative changes aimed at improving the effectiveness of tax administration in counteracting tax avoidance through transfer pricing.

Therefore, tax authorities and tax inspection authorities have been equipped with a full set of instruments improving access to information on taxpayers which was believed to be the main reason behind a limited interest of the tax inspectors in transfer pricing.

In Poland, legal regulations have been implemented to enable both an assessment of the risk that a group would use transfer pricing to avoid taxation (including the identification of both transactions and entities to be inspected) and an assessment of compliance with the arm's length principle when determining transfer prices. At the same time, due to improved international cooperation, Polish tax and tax inspection authorities have been improving their skills and capabilities for effectively conducting tax inspection, with the amount of additional tax assessments reaching hundreds of millions of PLN and still growing.

Until recently, transfer pricing was largely neglected by the tax and tax inspection authorities which focused in particular on VAT abuses.

However, in the immediate future, transfer pricing inspections are supposed to significantly contribute to increase budgetary receipts as the budgetary needs keep growing. The MoF's announcements and increased number and the level of detail of the inspections observed by us on the market confirm that these plans are being implemented.

Moreover, we have observed that the tax and tax inspection authorities rely on the development of their own resources (both employee competencies, databases and IT tools) which they intend to use to improve the effectiveness of inspections in the area of transfer pricing.

The results of these measures are becoming visible.

As shown in our survey, during a tax inspection taxpayers now may already face questions which show an increased level of insight into transfer pricing issues.

It should be remembered that, as a next step, the tax authorities will obtain additional tools enabling them to analyse transfer pricing more thoroughly.

These include extended documentation requirements which will already enter into force in 2017. For large taxpayers especially, these will mean that they not only need to prepare much more extensive documents and spend much more time to do so, but also to ensure transparency in intercompany settlements. By increasing the level of detail of the data which will need to be reported, and harmonizing the format of the documents (e.g. the CIT-TP declaration), any irregularities or deviations from the arm's length basis will become more visible.

This makes it necessary to develop a new approach to transfer pricing and to focus on planning rather than reporting as was the case to date.

Some of the taxpayers have already realized that they will need to revise their approach and prepare themselves for both potential inspections and for the new documentation requirements. They started preparing themselves by updating the format of group documents, developing policies and procedures and supplementing benchmark studies. However, it seems that many businesses still fail to grasp the importance and scope of the current and future transfer pricing obligations and postpone dealing with these issues. Contrary to what might be believed, there is not much time left for preparations. Next year may turn out to be full of changes for many taxpayers.

***Appendix: New
documentation
requirements –
description of
the documents***

5.1. Local file

The local file resembles the currently required format of transfer pricing documentation. However, the scope of information which will need to be presented therein has been extended. An overview of the changes has been presented below.

Comparison of mandatory elements of the local file

| | Current regulations | New regulations |
|--------------------------------------------|---------------------|-----------------|
| Functional analysis | ✓ | ✓ |
| Description of transfer pricing methods | ✓ | ✓ |
| Costs, payment terms | ✓ | ✓ |
| Business strategy, benefits, other factors | ✓ | ✓ |
| Justification of the method selected | - | ✓ |
| Benchmark study | - | ✓ |
| Financial data | ✓ (value) | ✓ |
| Organizational and management structure | - | ✓ |
| Restructuring | - | ✓ |
| Competitive environment | - | ✓ |
| Description of entities | ✓ (simplified) | ✓ |
| Taxpayer's documents | - | ✓ |

The most significant changes include expanding the requirements relating to the description of transfer pricing methods. Currently, it is acceptable to include only a description of the method applied. Under the new regulations, a taxpayer will have to justify the selection of a given method and explain why he believes the method will lead to an arm's length outcome. Moreover, the taxpayer will have to present a detailed algorithm of price calculation and fill it with actual financial data derived from the financial statements.

The local file will also have to cover a description of business restructuring transactions conducted by the taxpayer in the current or prior year.

Please note that a restructuring which has taken place in 2016 will have to be described in the transfer pricing documentation in accordance with the new requirements.

Please be reminded that in accordance with the Polish transfer pricing regulations, a restructuring shall mean (i) a transfer of functions, risks or assets which are associated with a potential for generating profits, or (ii) material renegotiation of agreements between group companies.

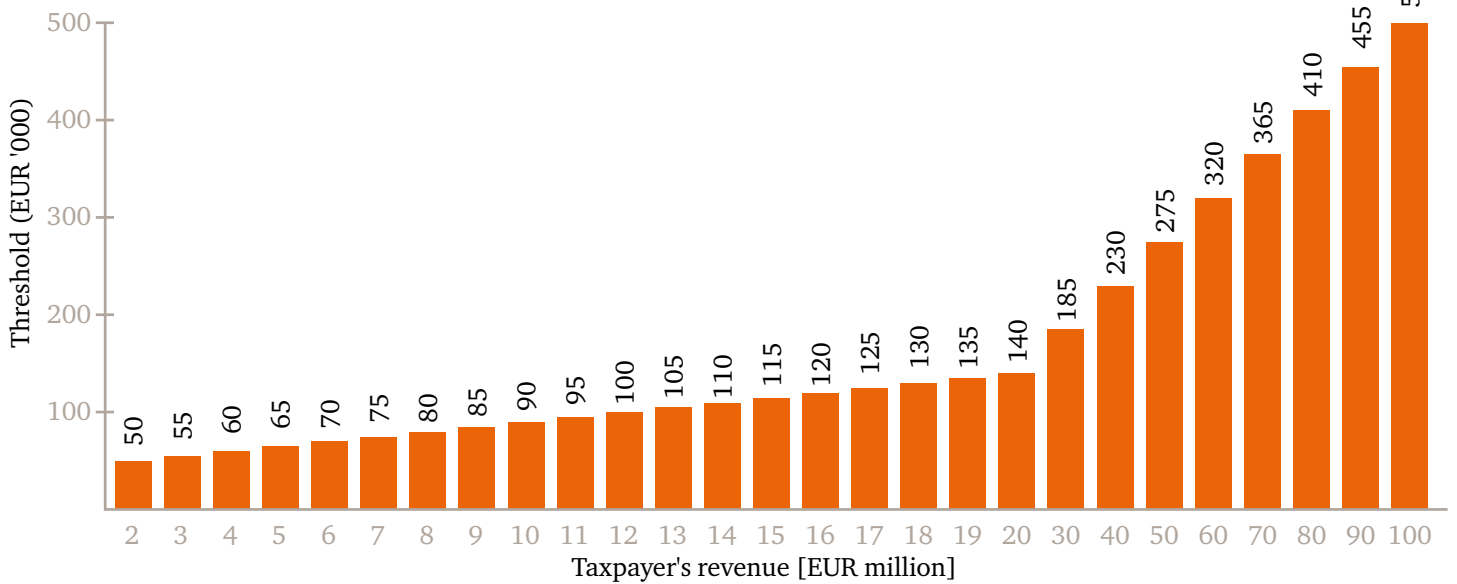
Moreover, it will be required to prepare documentation not only for the transactions with related entities (as is the case today), but also for “other events recorded in accounting records”, if they have a material impact on a taxpayer’s income or loss and were determined between related entities. Such events will include, in particular, cash pooling agreements, cost sharing agreements, articles of association of partnerships without legal personality, joint venture agreements or other similar agreements.¹²

Apart from the fact that the changes discussed above will certainly increase the burden of the taxpayer’s obligations, there are also positive aspects to the new regulations. Of the most favourable changes for the taxpayers involves the change of transaction materiality thresholds. Currently, irrespective of the size of an enterprise, the documentation requirement applies to any transactions whose value in a given year exceeded EUR 30 thousand for transactions involving services and intangible assets, EUR 50 thousand or EUR 100 thousand (depending on the relation of the transaction value to a company’s share capital) for transactions involving goods, and EUR 20 thousand for transactions with tax havens.

In accordance with the new regulations, the thresholds above which transactions must be documented will range from EUR 50 to 500 thousand. They will be set individually for each taxpayer, depending on the level of revenue generated.



New thresholds for the local file



Moreover, in accordance with the new requirements, in justified cases (i.e. when it is suspected that a transaction was not concluded on an arm's length basis), the tax authorities may demand documentation to be prepared even for transactions which do not exceed the said thresholds. In such cases, the taxpayer will have 30 days to prepare such documentation.

According to PwC:

On the one hand, this change will enable businesses to avoid documenting even the smallest transactions, but on the other hand, it will allow tax authorities to focus on material flows where the risk of shifting income is the highest. Therefore, taxpayers obligations will be reduced and, at the same time, the change may contribute to improving the effectiveness of tax inspections.

5.2. Benchmark studies

In the case of taxpayers whose revenues or costs exceeded EUR 10 million in the prior year, documentation will need to include an analysis of comparable company data (a benchmark study) which takes into account Polish entities conducting comparable activities, if available. The analysis will have to be prepared for individual transactions (rather than the entire business activity of a taxpayer).

If no benchmark data is available to enable a market analysis to be performed, a taxpayer will be obliged to prepare a description of compliance of the terms and conditions applied with the arm's length principle.

According to PwC:

The new regulations impose an obligation on the taxpayer to prove that transactions are executed on an arm's length basis. Compared with the currently applicable regulations whereby it is the tax office which must prove that a price is not consistent with an arm's length principle, imposing such an obligation is a qualitative change, because it transfers the burden of proof to the taxpayer.

5.3. Declaration

Similarly to the currently applicable regulations, a local file will not be automatically required to be submitted to a tax office. Instead, a taxpayer will have to submit, together with an annual tax return, a declaration that the said documentation for a given year has been prepared.

Therefore, the obligation to file a declaration in fact introduces a deadline by which the local file must be prepared – it is the date of filing a tax return. (One should remember that the said date is not clearly specified in the current regulations.)

However, the problem with a declaration is not only that taxpayers will have to exhibit stronger discipline in preparing the local file.

The introduction of the requirement to file the declaration also entails the question of responsibility for preparing the local file, which will be borne in the first place by the person signing the declaration. It should also be added that by signing the declaration, a signatory confirms not only that the documentation has been prepared, but also its technical correctness, consistency with the facts and the arm's length character of the respective settlements.

Therefore, introducing the declaration will make it easier for the tax authorities to “assign the blame” for transfer pricing irregularities and to punish the “guilty” person under the Fiscal Penal Code.

5.4. Master file

Taxpayers whose revenue or costs have exceeded EUR 20 million in the prior year will additionally be obliged to have documentation of the settlement mechanisms as seen from the perspective of the entire group to which they belong (the so called “master file”).

The said documentation will have to cover, in particular, a description of a group’s policies concerning transfer pricing and intangibles, including group strategies for their creation, development and maintenance.

A master file should be prepared by one entity from the group – it does not have to be prepared by each taxpayer separately. Therefore, one can use the materials prepared by the group. However, it should be remembered that they will probably need to be adjusted to Polish requirements.

5.5. CIT-TP declaration

The new regulations impose on taxpayers whose revenue or costs have exceeded EUR 10 million in a given year the obligation to prepare a report on transactions executed with related parties, i.e. a CIT-TP declaration. The declaration will be submitted to the tax office together with a tax return.

In order to prepare the declaration, it will be necessary to gather the key data on intercompany transactions and to conduct a general analysis of a taxpayer’s activities from the perspective of transfer pricing regulations. It will also be necessary to specify whether or not the taxpayer performed restructuring within the meaning of the transfer pricing regulations or whether or not the taxpayer paid or received the related exit fee.

The taxpayer will also have to specify the profile of its business activities and the role performed within the group. It should also be indicated that it will be necessary to precisely specify a taxpayer’s functional profile. For example, in the case of a producer, it will have to be clarified whether the functions performed and risks assumed by the taxpayer are those of a fully-fledged producer, or that of a contract manufacturer or a subcontractor. The answers provided must be carefully considered and result from a detailed analysis to ensure consistency with the transfer pricing documentation (both the local and master files), and with other information declared in the documentation prepared by other group companies.

5.6. CbC Reporting

The largest Polish groups (with consolidated revenue at group level of more than EUR 750 million) will be required to prepare a report on the amounts of income earned and tax paid and on the places where business operations are conducted.

Taxpayers will be obliged to provide a list of all entities belonging to the group, the countries where their registered offices are located, the main profile of business activities, the amount of tax paid as well as the profit earned, the number of employees and amount of fixed assets.

Similar reports will be prepared by the groups in other countries, and national tax authorities will exchange such information in accordance with the related OECD guidelines. The information provided will be used by the tax authorities to assess the risk of an infringement of the transfer pricing regulations, and therefore more effectively identify entities which should be inspected.

5.7. Limitation of the scope of entities preparing documentation

The new regulations provide for a number of smaller changes which clarify the existing regulations and limit the scope of entities obliged to prepare documentation when the risk and materiality of infringements are the lowest.

Consequently, an obligation to prepare documentation will not apply to:

- taxpayers whose revenues or costs have not exceeded EUR 2 million in a given year;
- taxpayers who have previously concluded an Advance Pricing Arrangement¹³ (APA) – with regard to the transactions covered in APA. Such taxpayers will be required to prepare simplified documentation containing only some components.
- transactions where the price or the manner of its calculation is determined by the law.

Moreover, a threshold for taxpayers being considered related in terms of capital will change – it will be increased from 5% to 25%.

13. APA is an agreement between a taxpayer and the tax authorities (MoF) on the manner of calculating transfer pricing. It is the equivalent of an individual tax interpretation with regard to transfer pricing regulations.

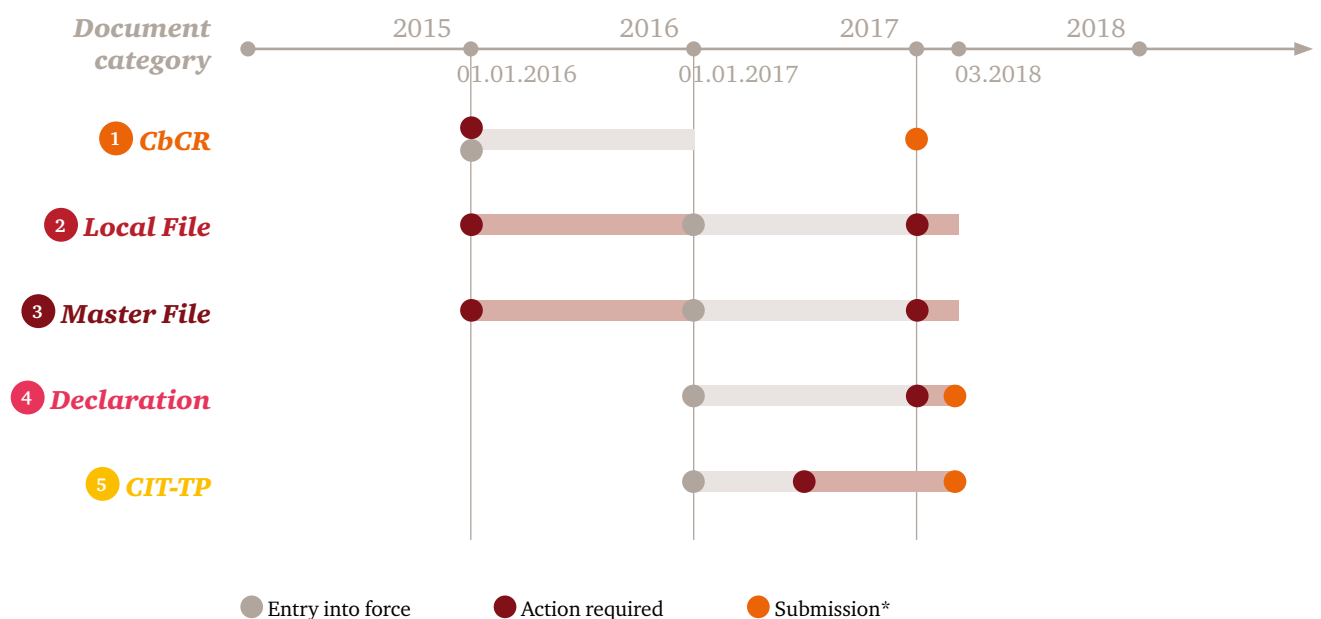
5.8. When will the new regulations enter into force and what will be the reporting dates?

New regulations on transfer pricing documentation will become effective on 1 January 2017 and will apply to transactions and events occurring after that date¹⁴. The only exception are the requirements for country-by-country reporting which entered into force on 1 January 2016.

After the changes become effective, preparation of the documentation will practically become a part of preparing a tax return.

Entities earning revenues exceeding EUR 10 million will be obliged to attach a CIT-TP declaration to their tax return. At the same time, they will be released from the obligation to submit ORD-U form which contains information on transactions concluded by a taxpayer with non-residents. In addition, in the case of CIT taxpayers, a taxpayer will be obliged to submit, together with a CIT return, a written declaration that a complete local file has been prepared.

Other components of the documentation need not be submitted to a relevant tax office together with the declaration, but they must be prepared within the same deadline. The only exception is the master file which must be prepared by the deadline of submission of an annual tax return by the group entity which will be preparing the master file.



* if fiscal year 2017 = calendar year 2017 and submission of 2 and 3 to the tax office within 7 days of the date of the related demand

14. For companies with a tax year ending on another date, the new regulations shall apply to periods beginning after the start of 2017.

Contact

To discuss in more detail how the issues presented above might affect your operations, please contact PwC experts:

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