INTANGIBLE SERVICES ACQUIRED FROM AFFILIATED ENTITIES – LIMITATION IN THE TREATMENT OF EXPENSES INCURRED AS REVENUE GENERATING COSTS

1. LEGAL REGULATIONS

On 1 January 2018, the amendments to the CIT Act entered into force. As pointed out in the explanatory memorandum to the bill, the principal objective of the introduced changes is the closer monitoring of the Corporate Income Tax, as a result of which the amount of the tax to be paid, in particular by large international entities, is to be more closely linked with the actual place of income generation. The proposed direction of the changes is parallel to the activities currently undertaken in other countries. In particular, it is correlated to the project implemented by the Organisation of Economic Cooperation and Development (OECD) devoted to counteracting taxable base erosion and profit shifting (BEPS).

Within the framework of the amended provisions, under Art. 15e of the CIT Act, effective as of 1 January 2018, taxpayers are obliged to exclude from their revenue generating costs specific kinds of expenses incurred directly or indirectly in favour of associated entities, as referred to in Art. 11 of the CIT Act, and the entities whose places of residence, registered offices, or management boards are located on the territory, or in a country, where harmful tax competition is applied (so-called tax-havens). This obligation applies to expenses incurred for:

(a) the acquisition of services such as advisory services, market research services, advertisement-related services, management and control services, data processing, insurance, guarantees and sureties, as well as other similar services,

(b) all kinds of payments and dues for the use, or the right to use, the rights or values referred to in Art. 16b Sec. 1 secs. 4 - 7 of the CIT Act (including copyrights or related property rights, licenses, the right determined in the Act dated 30 June 2000 - Industrial Property Law, the value constituting the equivalent of obtained information connected with knowledge in the area of industry, commerce, science or organisation know-how),

(c) the transfer of a debtor's insolvency risk on account of loans other than those granted by banks, cooperative savings, and credits unions (SKOKs), including within the framework of the obligations arising from derivative financial instruments, as well as other similar services.

The exclusion of the aforementioned expenses from tax allowed costs concerns the situation where these costs, in a given tax year, exceed 5% of the tax EBITDA, i.e. surplus of the sum of the revenues from all the sources of revenues, decreased by the interest revenues, over the sum of the revenue generating costs decreased by the value of the depreciation write-offs treated in a given tax year as revenue generating costs, as referred to in Art. 16a - 16m of the CIT Act, as well as the interest. Consequently, the calculation of the amount which should be excluded from the revenue generating costs should be made with the application of the following formula:

Limit amount = ([the sum of revenues from all sources – the revenues from interest] – [the sum of revenue generating costs – (the value of the depreciation write-offs treated in a given year as revenue generating costs + interest)] x 5%

In the case of banks, cooperative savings and credit unions (SKOKs), Krajowa Spółdzielcza Kasa Oszczędnościowo-Kredytowa, as well as the financial institutions listed in Art. 4 Sec. 1 sec. 7 of the Banking Law, this limit is determined without decreasing the revenues and the revenue generating costs by the interest revenue and interest costs.

The limitations in treating, as revenue-generating costs, the expenses incurred in connection with the acquisition of services from affiliated entities, and the entities from tax havens, do not apply where the total value of these expenses does not exceed PLN 3,000,000 in a tax year.

Additionally, this limit does not comprise, among other things, of the costs of services, or fees and dues, treated as revenue generating costs directly connected with the creation or acquisition, by a taxpayer, of goods or the rendering of services.

The amount of the expenses non-deducted in a tax year can be accounted for during the five successive tax years, on general terms, within the limits in force in a given year.

2. INTERPRETATIONS OF THE STATE FISCAL INFORMATION OFFICE

As early as at the stage of legislative works, a number of controversies have arisen in respect of the understanding, and, in particular, the scope of application of the new regulations. Unfortunately, the passing of the new Act has not dispelled these doubts. Taxpayers are unsure as to how to apply the newly introduced regulation in specific situations. This is why, following the publication of the Act, a number of queries to tax authorities have been sent on how to apply the newly introduced limitations. Below are the most important, already published interpretations issued by the director of the State Fiscal Information Office [“KIS”].

(a) **IT services** - interpretation no. 0111-KDIB2--1.4010.357.2017.2.MJ

The director of the KIS has stated that the expenses incurred in connection with IT-related services are not subject to the limitation arising from Art. 15e Sec. 1 of the CIT Act, because they are not comprised in the catalogue specified in this provision. We cannot treat these services as advisory services (i.e. providing specialist advice), data processing (comprising of the ordering, archiving, securing, or the providing of access to data), managing (i.e. giving orders, exercising management), or control (i.e. exercising supervision over someone, or something). The director of the KIS has, however, underlined that the expenses related to advisory services in connection with IT are comprised in the limit in question.

(b) **Bonus payment** – interpretation no. 0111-KDIB1--2.4010.442.2017.1.MM

Any costs connected with bonuses conveyed to affiliated entities were not subject to any limitation as regards their treatment as revenue generating costs. In the factual state which was the object of the interpretation, there was a case of a company belonging to an international group, which was paying bonuses to consumer groups. Each company from the group covered the bonus in accordance with the assumed allocation key. The amounts were conveyed to a German company which, in turn, conveyed them to the groups. The director of the KIS confirmed that the bonuses were not considered as costs connected with the acquisition of intangible services, as referred to in Art. 15e Sec. 1 of the CIT Act.

(c) **Services connected with engaging employees** - interpretation no. 0111-KDIB2--3.4010.25.2018.1.LG

The director of the KIS confirmed that the limitation in respect of revenue generating costs did not apply to services connected with engaging new employees. The case concerned a company which would acquire recruitment services from an associated entity in the meaning of Art. 11 of the CIT Act. These services comprised, among other things: of the determination of the necessary competence of the candidates, the verification of personal documents, the organisation of interviews and participation in the negotiation of employment conditions, and the determination of work and remuneration conditions. According to the director of the KIS, these services were not to be subject to the application of Art. 15e Sec. 1 of the CIT Act. The authority said that the aforementioned services should not be considered as advisory services, market research services, advertising services, management and control services, data processing or, similar services, as listed in the aforementioned regulation.

(d) **Production license** – interpretation no. 0111-KDIB2-3.4010.57.2018.2.AZE

The company applying for the interpretation was a producer and distributor of footwear. It acquired, by way of a license from an affiliated entity, the right to use its footwear designs, i.e. drawings, technical data sheets, as well as the relevant models and prototypes. The director of the KIS said that the license fees were connected to the manufactured goods. Without acquiring said license, the company would not be able to manufacture the shoes. The costs of the production license incurred in favour of an affiliated entity should be considered as costs directly connected with the manufacturing of the goods, in the meaning of Art. 15e Sec. 11 Item 1 of the CIT Act. Consequently, the limitations in respect of treating certain expenses as revenue generating costs, as referred to in Art. 15e Sec. 1 of the CIT Act, did not apply in this case.

A similar position has been expressed in an interpretation concerning an audio-visual license (0114-KDIP2-3.4010.66.2018.1.PS).

(e) **Trademark license** – interpretation no. 0111-KDIB1-1.4010.71.2018.2.MG

In the opinion of the director of the KIS, the limitations arising from Art. 15e of the CIT Act, did not comprise of the costs of the acquisition of a license for the use of a trademark. The interpretation concerned a company which dealt with, among other things, metal-forging and the wholesale of parts and accessories for cars. The company in question concluded, with its affiliated company, a license agreement on the use of a trademark (logo). The Tax Office confirmed that the

trademark was used in the course of production, and therefore, was directly connected to the goods manufactured by the company. Consequently, the company was not subject to the limitation referred to in Art. 15e Sec. 1 of the CIT Act.

(f) **Accounting services** - interpretation no. 0111-KDIB1-2.4010.2.2018.1.AW

The applicant asked the tax authority whether Art. 15e Sec. 1 of the CIT Act was applicable to accounting services, or any parts of these services, acquired by the applicant from a service provider, or affiliated entities with a registered office in Poland. The applicant was of the opinion that the answer to its question should be negative. The services in question would, therefore, not be subject to the limitation concerning their treatment as revenue generating costs. The director of the KIS shared the applicant's position. The director pointed out that although the CIT Act does not contain a legal definition of the services listed in Art. 15e Sec. 1 item 1 of the Act, i.e. as advisory services, market research, advertisement-related services, management and control services, data processing, insurance, guarantees and sureties, as well as similar services, there is, however, a similar expression that has been used in Art. 21 Sec. 2 item 2a of the CIT Act. Despite the fact that the above regulation applies to the obligations connected with the collection of flat-rate income tax, the identical nature of the notions justifies the application of the position expressed by the doctrine and the case law, developed in the context of Art. 21 Sec. 1 Item 2a of the CIT Act. In Art. 21 Sec. 1 item 2a of the CIT Act, there is a reference to accounting services, whereas they are not mentioned in Art. 15e Sec. 1 item 1. This means that the legislator has not included accounting services in the scope of the last article. Moreover, accounting services acquired from a service provider are not the same as advisory services, market research, advertisement-related services, management and control services, data processing, insurance, or guarantees and sureties. The accounting services rendered to the applicant did not have any common features with the aforementioned services. Consequently, according to the Authority, it should be concluded the notions of: services, market research, advertisement-related services, management and control services, data processing, insurance, and guarantees and sureties, as well as other similar services as used in Art. 15e sec. 1 item 1 of the CIT Act did not constitute the accounting services acquired from the service provider, as described in the application.

(g) **Services in the area of investment in real property** - interpretation no. 0111-KDIB1-1.4010.9.2018.1.SG

A particular joint-stock company, involved in investing in real property, applied for a tax interpretation. The company in question conducted their investment activity through partnerships established for this specific purpose. These partnerships, for the purpose of the entrusted undertakings, acquired services from, among others, affiliated entities. The applicant asked the director of the KIS whether the expenses incurred in connection with these services could be considered as revenue generating costs in their entirety, and, consequently, whether they were not subject to the limitation arising from Art. 15e Sec. 1 of the CIT Act. The tax authority stated that only the expenses connected with the activities related to the support during the designing and construction of the buildings and the accompanying infrastructure could be regarded as tax-allowed costs without limitations. On the other hand, the expenses connected with finding and acquiring sites for construction, support during the conclusion and servicing of the agreement with a bank on project financing, performing ongoing payments and

investment, project controlling, marketing services, the sale of individual areas in the developed building within the project (the so-called commercialisation), and the services connected with the administration of the real properties within the project, as well as any post-sale services of the project, were subject to the limitations arising from Art. 15e Sec. 1. In the case of these services, there was no direct connection between the acquisition of a good, or a service, and the revenue obtained from their sale and, consequently, the exclusion specified in Art. 15e Sec. 11 Item 1of the CIT Act would not apply.

(h) **Depreciation write-offs on know-how** - interpretation no. 0111-KDIB2-1.4010.4.2018.1.ZK

In 2010, an applicant acquired the rights to use know-how ("Know-How"). Due to the fact that this Know-How was used for a period of time longer than one year, the Company, on the basis of Art. 9 of the CIT Act, recorded this Know-How in the register of fixed assets and intangible assets at the value specified in the purchase agreement. The company used the Know-How in the course of its business activity and made depreciation write-offs which constituted revenue generating costs under Art. 16a-16m of the CIT Act. The applicant asked the director of the KIS whether, following the amendment of the regulation, it would still be able to consider the depreciation write-offs of the expenses incurred for the acquisition of the know-how as revenue generating costs. The tax authority confirmed that as of 1 January 2018, the company would be subject to the limitations arising from Art. 15e Sec. 1 item 2 of the CIT Act, because the fees for the rights to use the know-how were listed in the catalogue of expenses mentioned in this regulation. It was immaterial whether the taxpayer made depreciation write-offs in connection with the expenses incurred for the acquisition of this right. As explained in the interpretation, the fact of making depreciation write-offs was merely the treatment of an element of the company's assets as a cost of the company's operation, albeit spread over a period of time. Consequently, the depreciation write-offs made on the basis of the CIT Act could not be treated in any way other than revenue generating costs, because these two types of deductions led to a factual decrease of the revenue. The above was directly confirmed in Art. 15 Sec. 6 of the CIT Act.

3. EXPLANATIONS OF THE MINISTER OF FINANCE

Comprehensive explanations on the principles of the application of the limitations arising from the new regulations of Art. 15e of the CIT have been published on the website of the Minister of Finance. These explanations are available at this address:

https://www.finanse.mf.gov.pl/abc-podatkow/znajdz-informacje/-/asset_publisher_faceted/e8GP/content/ograniczenie-wysokosci-kosztow-uzyskania-przychodow-zwiazanych-z-nabyciem-niektorych-rodzajow-uslug-i-praw-art-15e-ustawy-o-cit?_101_date_INSTANCE_e8GP_categoryId1=746881&_101_date_INSTANCE_e8GP_categoryId2=967662&_101_date_INSTANCE_e8GP_categoryId3=746979&redirect=https%3A%2F%2Fwww.finanse.mf.gov.pl%2Fabc-podatkow%2Fznajdz-informacje%3Fp_p_id%3D101_date_INSTANCE_e8GP%26p_p_lifecycle%3D0%26p_p_state%3Dnormal%26p_p_mode%3Dview%26p_p_col_id%3Dcolumn-2%26p_p_col_pos%3D1%26p_p_col_count%3D2%26_101_date_INSTANCE_e8GP_categoryId3%3D746979%26_101_date_INSTANCE_e8GP_process%3Dtrue%26_101_date_INSTANCE_e8GP_categoryId1%3D746881%26_101_date_INSTANCE_e8GP_categoryId2%3D967662%26_101_date_INSTANCE_e8GP_orderFilter%3DcreateDate%26_101_date_INSTANCE_e8GP_struts_action%3D%252Fasset_publisher_faceted%252Fview

4. SUMMARY

The new solutions introduced to the CIT Act in respect of the limitation of treatment, as revenue generating costs, of expenses incurred for intangible assets acquired from affiliated entities face a number of problems concerning their practical application. The problems in question arise, first of all, from the fact that the legislator has used vague notions in the new provisions, without providing any specific definitions of these notions, as well as from the fact of the creation of an open catalogue of services to which the limitations arising from Art. 15e Sec. 1 of the CIT Act would apply.

The regulation in force as of 1 January 2018 also has other defects: the legislator has failed to explain how the limits specified in the provisions - PLN 3,000,000 and 5% of EBITDA should be applied for the calculation of the CIT advance payments in the course of the tax year.

In order to ensure tax security, taxpayers should review the agreements concluded with their affiliated entities, or the entities with their registered office in tax havens and determine which of them are subject to the limitations arising from the provisions of Art. 15e of the CIT Act. In case of doubt, we recommend applying for an interpretation of the relevant provisions of the Tax Law.