TAXATION OF FREE OF CHARGE BENEFITS

The most recent few months saw the administrative courts frequently deal with the subject of the so-called free of charge benefits received by employees or business collaborators. The absence of a statutory definition of the term "free of charge benefit" combined with differences in interpretation have repeatedly led to disputes between taxpayers and tax authorities. The ambiguity of regulations and lack of due care and diligence as regards the actions of entrepreneurs on the one hand and the particularly thorough audits carried out by tax authorities on the other hand often result in the upward adjustment of employees' income and the increase of the financial burdens imposed on entrepreneurs.

Of late, the administrative courts have issued judgments in the following cases concerning free of charge benefits.

Participation by an employee in a company event does not always generate income for the employee

Judgment of the Supreme Administrative Court of 20 February 2013, case ref. no. II FSK 1256/11

A company organized integration events for its employees, for which it paid for the employees' cinema or concert tickets and refreshments. It was the opinion of the tax authorities that the company should calculate the value of the free of charge benefits made to each of its employees and make advance personal income tax payments.

The Supreme Administrative Court did not agree with the view of the tax authorities and in its opinion only a free of charge benefit that an employee actually used may be subject to taxation. One cannot assume that just the opportunity itself to use a benefit generates taxable income.

Participation by an employee in a company event is not taxable

Judgment of the Supreme Administrative Court of 24 January 2013, case ref. no. II FSK 1064/11

A company organized an integration event to which all employees were invited. It was the opinion of the tax authorities that the employer should calculate to what degree each of the invited employees used the benefits available during the event and tax them.

The Supreme Administrative Court did not agree with the view of the tax authorities and in its opinion free of charge benefits constitute employee income only in the event that an employee does actually receive them. If the company is unable to determine to what degree its employees used the benefits available during the integration event, then consequently it is not able to precisely determine the income for each of the employees and tax it.

Free of charge benefits in management contracts

Judgment of the Supreme Administrative Court of 6 December 2012, case ref. no. II FSK 709/11

The Supreme Administrative Court found that it is not only the amount of remuneration for performance of specific duties that constitutes a manager's income subject to income tax, but also the value of benefits in-kind received by the manager, such as the ability to use a company car, mobile phone or laptop – even if it is for work purposes.

In the court's opinion, the use by managers of company cars, mobile phones and computers constituting company property, represents an additional element of their remuneration. The court agreed with the tax office which maintained that seeing that managers perform their duties based on enterprise management contracts, they conduct personal business activities, and subsequently the company as the withholding agent is obliged to make advance personal income tax payments.

Culture and recreation vouchers given to employees are not subject to income tax exemption

Judgment of the Supreme Administrative Court of 23 November 2012, case ref. no. II FSK 675/11

A company issues culture and recreation vouchers which are then given by companies that order them to their employees for free as additional benefits. It was the opinion of the tax authorities that the vouchers had the nature of an identification note enabling the holder to exchange them for a service, and therefore could not be deemed to constitute a benefit in-kind financed from the company social benefit fund and as such exempt from income tax.

The above view was approved by the Supreme Administrative Court. It follows from the reasons for the judgment that the real meaning of a culture and recreation voucher is not for an employee to receive a benefit in-kind, e.g. a cinema ticket, but to receive a service consisting in the ability to see a movie. Fundamentally, an identification note itself has no value at all as it cannot be used to obtain a given service. As a result, an employee that receives a culture and recreation voucher giving him/her the right to use a given service, e.g. see a movie at the cinema, receives additional income from the employment relationship on account of the free of charge benefit.

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Having regard to the above judgments, due care has to be exercised when dealing with any benefits received by employees. It is worth remembering that to date no uniform jurisprudence has been established as regards free of charge benefits, and consequently the opinions of individual courts and tax authorities may vary significantly even in reference to similar cases. Furthermore, it should be emphasised that the issue of possible qualification of benefits as free of charge and taxable does in each and every case depend on the specific circumstances of the case. **We wish to point out that in reality the irregularities in respect of tax treatment of free of charge benefits may lead to considerable tax risks and as a result to substantial financial burdens.**

DRAFT CHANGES AS REGARDS CIT AND PIT

A draft act amending the CIT and PIT acts was published on 12 February 2013. The most significant of the planned changes refers to limited joint-stock partnerships and limited partnerships – as it is planned to include them in the subject matter of the CIT act. In other words, **limited joint-stock partnerships and limited partnerships would be subject to income tax in the same way as currently for instance limited liability companies.** Furthermore, the amendment provides for, amongst others:

- introduction of regulations identifying the manner of determining the value of income and costs of benefits in-kind;
- introduction of a mechanism for voluntary donation of 1% of CIT to scientific institutions operating in the field of development of innovative technologies and products;
- modification of regulations concerning the so-called thin capitalization and exclusion of the ability to include in tax deductible expenses the interest on loans granted by indirectly affiliated entities indirectly holding at least 25% of shares over the treble value of the share capital;
- introduction of rules for determining the initial value of fixed assets in a European company, European co-op and a foreign facility located within the territory of the Republic of Poland;
- deferment of income tax on account of making an in-kind contribution to a limited liability company or a joint stock company in the form of a patent and other rights referred to in the industrial property act, copyright, know-how and licenses related thereto;

- exclusion of the right to tax exemption in the event of payment of dividends and other income (revenue) on account of participation of legal persons subject to recognition as tax cost in the company paying the dividends, etc. (the so-called participation loan).

From among the proposed changes, the most important one from the point of view of entrepreneurs seems to be the double taxation of income of limited joint-stock partnerships and limited partnerships. Introduction of the proposed changes will undoubtedly result in the increase of the financial burdens imposed on entrepreneurs operating as the abovementioned partnerships. **Therefore, it is worth considering the implications of the proposed changes for the business activities carried out, and develop an alternative, tax efficient ownership structure.** However, it is worth mentioning that as regards the general partners in limited joint-stock partnerships and limited partnerships, the negative effects of the tax increase will be mitigated by their ability to deduct part of the tax paid by a joint-stock partnership or limited partnership. In economic terms, this may still mean single taxation of general partners.

CASE LAW REGARDING CORPORATE INCOME TAX

Only the nominal value of taken up shares constitutes an income as regards in-kind contributions to limited liability companies and joint stock companies

Judgment of the Voivodship Administrative Court in Gliwice of 16 January 2013, case ref. no. I SA/Gl 234/12

For the purpose of restructuring its activities, a company planned to make in-kind contributions to its subsidiaries in exchange for shares and stock with the nominal value lower than the market value of the subject of the contribution in-kind. The surplus over the value of the taken up shares was to be transferred to the supplementary capital of the individual subsidiaries. In the opinion of the company, the only income on account from the contribution in-kind should be the nominal value of the shares taken up by the company, and the tax authority is not able to determine the company's income at a different level.

The correctness of the above view of the company was confirmed by the Voivodship Administrative Court in Gliwice. In the court's opinion, the legislator unambiguously predetermined that in the case of a contribution in-kind in the form of assets, it is the nominal value of the shares, which is fixed and independent of agreements relating to contributions, that constitutes an income.

In our opinion, the above judgment is favourable from the point of view of entrepreneurs and must be applauded. Nevertheless, the judgment of the Voivodship Administrative Court in Gliwice should be treated with caution as in respect of the above issue tax authorities frequently apply regulations concerning determination of income at a sale of assets, which consequently results in determination of income not at the nominal value of the taken up shares but at the market value of the subject of the contribution in-kind.

A lost bid bond cannot constitute a tax deductible expense

Judgment of the Voivodship Administrative Court in Cracow of 4 December 2012, case ref. no. I SA/Kr 1609/12

An entrepreneur took part in a tender for the sale of tangible assets, the invitation to which was issued by a trustee in bankruptcy, and paid the bid bond. However, it was revealed that the invitation was fictitious and the tender did not take place. The prosecutor's office dropped made the decision to discontinue the investigation in respect of the case under consideration as they were unable to find the person responsible.

However the Voivodship Administrative Court in Cracow decided that the loss incurred on account of the bid bond lost by the entrepreneur cannot be deemed to constitute a tax deductible expense. In the court's opinion, the expense was not incurred for the purpose of achieving income, and the entrepreneur failed to exercise due care and did not use all of the measures available to verify whether the invitation to tender was an authentic one.

In our opinion, the above judgment does not deserve to be endorsed. However, taking into consideration its content and the practices of tax authorities, including this type of expenses in tax deductible expenses should be treated with caution. The most recent judgments and individual interpretations seem to confirm the view according to which a lost bid bond is excluded from tax deductible expenses even when the loss is due to reason unattributed to the entrepreneur.

CASE LAW REGARDING VAT

Uniform VAT rates for similar products

Judgment of the Supreme Administrative Court of 28 January 2013, case ref. no. I FSK 697/12

A company is active in the field of sale of ladyfingers, tortillas and muffins. Pursuant to the regulations on VAT, the above products may use the 8% VAT rate for taxation provided that their minimum durability date does not exceed 45 days. In the producer's opinion it is not justified to apply different rates to the same assortment of products, i.e. baked goods and biscuits, which differ only in their minimum durability date. In other words, the best-before-date cannot constitute the only criterion allowing application of a lower VAT rate.

The Supreme Administrative Court agreed with the view of the taxpayer and stated that the principles for allocation of VAT rates to certain goods and services applicable in Poland contradict the idea of VAT itself – the principles of simplicity of taxation and neutrality. In the court's opinion, the regulations of the VAT Directive include distinct guidelines and limitations developed on the EU ground which have to be respected by member states when introducing lower VAT rates. First and foremost, the isolation of certain and specific goods from a given category has to ensure easy application of the lower rate. Moreover, products remaining in competition with each other, i.e. products that are seen as substitutes by consumers and that can be used to meet the same needs cannot be treated differently in respect of VAT. Finally, the developed system has to be precise and uncomplicated, otherwise it will be susceptible to abuse, creating a temptation to illegally apply lower VAT rates.

In our opinion, it is difficult to forecast what stance in respect of the above judgment is going to be taken by the tax authorities. To date the jurisprudence was always fully in agreement with the tax office. However, the precedent opinion expressed by the Supreme Administrative Court in the above judgment must be applauded and may constitute a vital argument in a potential dispute with a tax authority concerning application of lower VAT rates.

A taxpayer has the right to apply for an individual interpretation in respect of a business partner issuing VAT invoices to the taxpayer in consideration

Judgment of the Supreme Administrative Court of 8 January 2013, case ref. no. I FSK 1572/12

A company put forward an enquiry to a tax authority whether the acquisition of fixed assets and equipment should be subject to VAT exemption. The tax authority refused to issue an interpretation to the above enquiry concluding that it regarded the applicant's business partner, and therefore the company could not constitute a concerned entity within the meaning of the Tax Ordinance.

The Supreme Administrative Court did not agree with the view of the tax authority and stated that due to the specific structure of VAT, the main elements of which are the institutions of input and output tax, the situation of the company's business partner has direct legal and tax implications for the applicant.

In our opinion, owing to the complicated legal and tax regulations, the ability to obtain a binding interpretation of the provisions of tax law is extremely valuable from the point of view of taxpayers. In particular, from the point of view of a purchaser of goods or services, it is vital to have the certainty that a given transaction is correctly taxed with VAT. Therefore, the above judgment of the Supreme Administrative Court must be applauded.

BSJP Brockhuis Jurczak Prusak Sp. k.

The law firm BSJP Brockhuis Jurczak Prusak Sp. k. has long experience in providing legal and tax advice to foreign and domestic entrepreneurs in Poland. We provide comprehensive solutions, based on our excellent knowledge of the key industries.

The BSJP tax department provides services in regard to, among others:

- ✓ assessment of tax consequences and drawing up of most advantageous scenarios for conclusion of transactions safe from the tax point of view, as well as tax advisory throughout the transaction;
- ✓ development of optimum tax structures used for conducting business activities, including international structures;
- ✓ conducting mergers and acquisitions and restructuring programmes in the most advantageous manner safe from the tax point of view;
- ✓ tax optimization in regard to management remuneration;
- ✓ tax analysis of agreements concluded by our clients aimed at elimination and mitigation of tax related risks;
- ✓ ongoing tax advisory in relation to business activities conducted concerning, among others: income taxes, VAT, transfer tax and real estate tax;
- ✓ drawing up of documentation in regard to transfer pricing;
- ✓ client support and representation during tax proceedings and before administrative courts.

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