

Capital flows and the obligation to prepare transfer pricing documentation

Although the PIT Act and the CIT Act contain a definition of a controlled transaction, it still raises a lot of emotions in the context of defining the documentation obligation.

According to the regulations, a controlled transaction is understood as an activity of an economic nature identified on the basis of the actual behavior of the parties, including the attribution of income to a foreign permanent establishment, the terms whereof have been established or imposed as a result of affiliations.

The above regulation thus indicates that two basic prerequisites must be met **for a controlled transaction to occur**:

- setting or imposing terms of activities as a result of affiliations
- taking actions of an economic nature.

Applying the above-mentioned regulations to the institutions of commercial law and capital movements related to the functioning (often recapitalization) of capital companies, it should be emphasized that these activities are often not identified by taxpayers as transactions subject to documentation, which leads to incompleteness of transfer pricing documentation for a given tax year.

As confirmed in interpretations issued by the tax authorities, the aforementioned definition of a controlled transaction covers such activities as: making contributions to the company, additional payments from shareholders or the forced or voluntary acquisition of shares with a view to their redemption. However, the payment of dividends remains outside the scope of the controlled transaction.

Below we present the positions of the tax authorities in the said area:

CONTRIBUTION TO A COMPANY	<p>Taking up of shares in exchange for a cash contribution constitutes a controlled transaction subject to the documentation obligation if the contribution exceeds the transaction value threshold of PLN 2 million (the threshold for "other transactions").</p> <p>The above position was confirmed by the Head of the National Revenue Information Service in the individual interpretation of 15 May 2020. (ref. 0111-KDIB1-2.4010.81.2020.2.MS).</p> <p>Furthermore, the authority pointed out that the transaction could not benefit from the exemption for domestic transactions referred to in Article 11n(3) of the CIT Act because it was a "capital transaction" which was explicitly excluded from the scope of the exemption.</p>
SHAREHOLDERS' ADDITIONAL PAYMENTS	<p>Events involving the adoption of resolutions on the obligation of shareholders to make additional payments and the payment of such additional payments constitute controlled transactions subject to the obligation to prepare transfer pricing documentation if the value of transactions of a homogeneous nature exceeds the statutory threshold applicable to financial transactions, i.e. PLN 10 million.</p> <p>An additional payment is a specific type of consideration in cash from the shareholders to the company. According to the tax authorities, an additional payment, even though it is not a loan, has characteristics similar to a loan, namely – it is repayable (Article 179 of the Code of Commercial Companies), is a source of financing for the Company (the so-</p>

	<p>called internal source as opposed to a loan, which is an external source of financing). In addition, as the tax authorities claim, Article 11n (3) of the CIT Act does not apply in the case of additional payments, because this provision excludes from the obligation to draw up documentation the transactions which do not constitute revenue or deductible costs. As the wording of the provision clearly implies, this rule does not apply, i.a. to financial transactions, which are considered to be additional payments.</p> <p>The position in this respect was presented, i.a. in the interpretation of the Head of the National Revenue Information Service dated 17 August 2020. (ref. 0111-KDIB1-2.4010.166.2020.2.AK).</p>
COMPULSORY OR VOLUNTARY REDEMPTION OF SHARES	<p>A compulsory and voluntary acquisition of shares with a view to their redemption constitutes a controlled transaction that is subject to the documentation requirement if the threshold applicable to "other transactions" of PLN 2 million is exceeded.</p> <p>Moreover, a voluntary redemption of shares without remuneration also qualifies as a controlled transaction and is subject to the documentation obligation.</p> <p>The position in this respect was presented, i.a. in the interpretation of the Head of the National Revenue Information Service dated 10 June 2020. (ref. 0111-KDIB2-1.4010.112.2020.1.AR).</p>
DIVIDENDS	<p>A dividend payment does not constitute a controlled transaction and is therefore not subject to documentation requirements.</p> <p>This position was confirmed by the Minister of Finance in his response to parliamentary interpretation no. 9368 of August 22, 2020 indicating that the payment of dividends cannot be seen as an economic activity. Dividends are in fact remuneration for the capital entrusted, but the profit generated, as well as its distribution and payment, are merely the consequence of an economic activity and not an activity in the strict sense.</p>
GUIDELINES	<p>Given the above-mentioned positions of the tax authorities, a specific analysis of all activities between related parties and their economic nature is a very important issue when identifying transfer pricing obligations. In practice, the obligation also extends to atypical economic events, which at first glance are often perceived by taxpayers as ordinary day-to-day activities associated with the operation of companies.</p>
CONTACT US	<p>This document has been prepared for information purposes only and covers general nature. Before taking any action based on the above information, we recommend that you obtain a valid opinion of TPA experts.</p> <div>  <p>Joanna Kubińska Associate Partner, Head of Transfer Pricing +48 502 184 882 joanna.kubinska@tpa-group.pl</p> </div>

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