

## Draft general interpretation of the Minister of Finance regarding the definition of a "controlled transaction"

As we mentioned in one of our recent alerts, the definition of a "controlled transaction" still raises a lot of emotions in the context of its interpretation and, consequently, of the determination of the documentation obligation.

In response to numerous requests from taxpayers related to difficulties in interpreting the above-mentioned definition, the Ministry of Finance announced tax consultations regarding the draft general interpretation of the Minister of Finance, Funds and Regional Policy regarding the concept of "controlled transaction".

The general interpretation is intended to clarify what should be understood by the term "controlled transaction" due to the identified interpretation difficulties with respect to its individual elements, as well as to ensure uniform application of the provisions by tax authorities.

**The content of the draft refers in its wording to the determinants allowing for the recognition of a given activity as a "controlled transaction", as well as directly refers to corporate relations (such as, among others: payment of dividends, additional payments), without covering the issue of free of charge benefits or the allocation of income to a permanent establishment.**

**The most important issues referenced in the project are outlined below:**

### THE CONCEPT OF A CONTROLLED TRANSACTION RESULTING FROM THE PIT / CIT ACT

According to the regulations (Article 11a par. 1 point 6 of the CIT Act and Article 23m par. 1 point 6 of the PIT Act), a controlled transaction is understood as **economic activities** identified on the basis of the **actual behaviour of the parties**, including attribution of income to permanent establishment, **the terms of which were established or imposed as a result of relations**.

### DETERMINANTS FOR RECOGNIZING AN ACTIVITY AS A CONTROLLED TRANSACTION

According to the draft general interpretation, **the recognition of a given activity as a controlled transaction requires the total fulfilment of three prerequisites:**

#### 1. Activities must be of an economic nature

The draft emphasizes that an activity of an economic nature requires the existence of the same characteristics (attributes) that define an economic activity, but it is not required to conduct an economic activity in each case.

Let us recall: "economic activity" is a concept understood as, inter alia:

- activities aimed at earning profit (profit-oriented, property justification);
- activities within an organized structure;
- activities of an independent (autonomous) nature.

#### 2. Actual conduct of the parties

Bearing in mind that the tax acts do not contain a definition of "actual conduct of the parties", the conduct of the parties should be viewed **from the perspective of actually performed transactions**, and not only those that appear in the content of the agreements.

Furthermore, the assessment of whether we are dealing with a controlled transaction should be made from the perspective of each of the participants in the transaction.

### **3. Activity conditions are established or imposed as a result of the relations**

From the perspective of the definition of "controlled transaction", it is crucial that the terms and conditions of economic activities are determined or imposed as a result of relations.

As indicated in the draft, for the identification of a "controlled transaction" it is not sufficient for economic activities to be performed by related entities. It is necessary that the terms of such activities are determined or imposed as a result of the relations. There may be situations when the activities are of an economic nature and are performed between related entities, but are not established or imposed as a result of relations.

Moreover, in accordance with the draft interpretation, in order to determine whether we are dealing with a controlled transaction, it does not matter whether the discussed activities were performed under the arm's length principle or on the terms inconsistent with this principle.

## **INTERNAL COMPANY RELATIONS**

According to the above-mentioned draft, the prerequisite in the form of "activity conditions established or imposed as a result of the relations" is important from the perspective of corporate relations of companies, which are often subject to a legal regime (e.g. actions of the parties result from corporate relations and are determined by specific provisions of law, e.g. of the Commercial Companies Code).

If the activities of an economic nature identified on the basis of the actual behaviour of the parties are determined (shaped) by the provisions of law (including when they result from the contract between the parties required by the provisions or other legal or actual activities), then the conditions of activities taken (e.g. at the company-partner level) are not determined or imposed as a result of relations (because the parties to these activities do not have an objective influence on taking them).

Such activities cannot be considered a controlled transaction. Therefore, it is necessary to analyze specific intra-group activities on a case-by-case basis.

**The draft indicates that such activities as:**

- payment of dividends,
- payment of profit by a non-legal entity to its shareholders, and
- additional payments,

**do not constitute a controlled transaction within the meaning of the transfer pricing regulations, as such activities are not established or imposed as a result of relations.**

## **SUMMARY**

To sum up, the above-mentioned draft interpretation may be positively received by taxpayers who often have problems with identifying corporate relations as transfer pricing obligations or simply do not remember to take them into account when identifying obligations to prepare transfer pricing documentation.

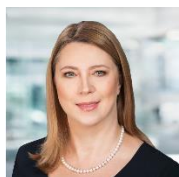
However, it should be borne in mind that at the moment it is only a draft interpretation subject to consultations and the final content of the official general interpretation may still be changed.

## **DEADLINE FOR SUBMITTING CONSULTATIONS**

Consultation on the definition of a controlled transaction is open to all entities. The deadline for submitting comments, views and opinions along with their justification has been set **until April 30, 2021**.

## CONTACT US

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.



**Joanna Kubińska**

*Associate Partner,  
Head of Transfer Pricing*

+48 502 184 882

[joanna.kubinska@tpa-group.pl](mailto:joanna.kubinska@tpa-group.pl)

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