

## ORDINANCE OF THE MINISTER OF FINANCE

of 10 October, 1997

### **on the Mode and Procedure of Determining Taxpayers' Income by Estimating Prices in Transactions Effected by These Taxpayers** *(Dz.U. 128 of 22 October 1997, Item 833)*

Pursuant to Article 11 Clause 9 of the Corporate Income Tax Law of 15 February, 1992 (Dz.U. 1993, No. 106, Item 482 and No. 134, Item 646; 1994, No. 1, Item 2, No. 43, Item 163, No. 80, Item 368, No. 87, Item 406, No. 90, Item 419, No. 113, Item 547, No. 123, Item 602 and No. 127, Item 627; 1995 No. 5, Item 25, Item 86, Item 433, No. 96, Item 478, No. 133, Item 654 and No. 142, Item 704; 1996 No. 25, Item 113, No. 34, Item 146, No. 90, Item 405, No. 137, Item 639 and No. 147, Item 686; 1997 No. 9, Item 44, No. 28, Item 153, No. 79, Item 484, No. 96, Item 592, No. 107, Item 685, No. 118, Item 754, No. 121, Item 770, No. 123, Item 776 and 777) and Article 25 Clause 8 of the Personal Income Tax Law of 26 July, 1991 (Dz.U. 1993 No. 90, Item 416 and No. 134, Item 646; 1994 No. 43, Item 163, No. 90, Item 419, No. 113, Item 547, No. 123, Item 602 and No. 126, Item 626; 1995 No. 5, Item 25 and No. 133, Item 654; 1996 No. 25, Item 113, No. 87, Item 395, No. 137, Item 638, No. 147, Item 686 and No. 156, Item 776; 1997 No. 28, Item 153, No. 30, Item 164, No. 71, Item 449, No. 85, Item 538, No. 96, Item 592, No. 121, Item 770 and No. 123, Item 776), the Minister of Finance hereby orders what follows:

#### **Chapter 1** **General Rules**

##### **Paragraph 1**

1. The provisions of this Ordinance govern the mode and procedure of determining income, by estimating prices, referred to in Article 11 of the Corporate Income Tax Law of 15 February, 1992 (Dz.U. 1993, No. 106, Item 482 and No. 134, Item 646; 1994, No. 1, Item 2, No. 43, Item 163, No. 80, Item 368, No. 87, Item 406, No. 90, Item 419, No. 113, Item 547, No. 123, Item 602 and No. 127, Item 627; 1995 No. 5, Item 25, Item 86, Item 433, No. 96, Item 478, No. 133, Item 654 and No. 142, Item 704; 1996 No. 25, Item 113, No. 34, Item 146, No. 90, Item 405, No. 137, Item 639 and No. 147, Item 686; 1997 No. 9, Item 44, No. 28, Item 153, No. 79, Item 484, No. 96, Item 592, No. 107, Item 685, No. 118, Item 754, No. 121, Item 770, No. 123, Item 776 and 777) and in Article 25 of the Personal Income Tax Law of 26 July, 1991 (Dz.U. 1993 No. 90, Item 416 and No. 134, Item 646; 1994 No. 43, Item 163, No. 90, Item 419, No. 113, Item 547, No. 123, Item 602 and No. 126, Item 626; 1995 No. 5, Item 25 and No. 133, Item 654; 1996 No. 25, Item 113, No. 87, Item 395, No. 137, Item 638, No. 147, Item 686 and No. 156, Item 776; 1997 No. 28, Item 153, No. 30, Item 164, No. 71, Item 449, No. 85, Item 538, No. 96, Item 592, No. 121, Item 770 and No. 123, Item 776).
2. The objective of the application of the provisions of this ordinance shall be to determine and tax income which can reasonably be deemed to have been earned in the territory of the Republic of Poland, and with respect to domestic entities -- also income earned abroad, if it can

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reasonably be attributed to these entities.

3. The provisions of the ordinance shall not apply to transactions in which the price or mode of setting the price of the object of such a transaction is prescribed in the laws and enforcement regulations issued on the basis of the laws.
4. For the purpose of this ordinance, the following terms shall be understood as:
  - 1) entity -- an individual, a corporate entity or an entity without legal personality,
  - 2) related entities -- entities which are in relations referred to in Article 11 Clauses 1 and 4-7 of the law first mentioned in Clause 1 and Article 25 Clause 1 and 4-7 of the other law mentioned in Clause 1 respectively,
  - 3) unrelated entities -- entities which are not in relations referred to in Item 2,
  - 4) fair market value -- value established on the basis of the price set in accordance with the methods referred to in Paragraphs 4-6 and Paragraph 12.

## **Paragraph 2**

1. The tax authorities and the tax inspection authorities shall examine whether income earned by a taxpayer from a transaction with a related entity was determined on the basis of the fair market value of the object of the transaction, properly booked and allocated between the parties.
2. Examination referred to in Clause 1 shall cover in particular all types of transactions involving transfer of ownership of tangibles and intangibles or transfer of these tangibles or intangibles for use as well as grant of loans (credits) and provision of services.

## **Paragraph 3**

1. The tax authorities or the tax inspection authorities shall be obligated to determine the fair market value of the object of a transaction between related entities on the basis of all information available to them which may affect determination of this value.
2. On determining the fair market value of the object of a transaction and determining income on this basis, the tax authorities or the tax inspection authorities shall be obligated to ensure that taxpayers can actively participate at each stage of the proceedings, in particular that they can submit to these authorities documents, notes and other data which formed the basis for the calculation of the price.
3. On determining the fair market value of the object of a transaction, the tax authorities or the tax inspection authorities shall not take into account circumstances which the parties could not be aware of on the date of concluding the transaction and which, had they been known to the parties, might have caused the parties to determine a higher or lower value of the object of such a transaction.
4. Where a taxpayer determined the fair market value of the object of a transaction based on a method or methods referred to in Paragraphs 4-6 and submits to the tax authorities the data referred to in Clause 2, and the reliability and objectiveness of the data submitted are not justifiably questioned, the authorities shall determine the fair market value of the object of such a transaction using the method applied by the taxpayer, unless application of another method is evidently more appropriate in light of the provisions of the ordinance and the data available.

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## **Chapter 2**

### **Basic Methods of Determining Taxpayers' Income by Price Estimation**

#### **Paragraph 4**

1. The comparable uncontrolled price method shall involve comparison of the price agreed in transactions between related entities with the price applied in comparable transactions by unrelated entities and determination, on this basis, of the fair market value of the object of the transaction concluded between the related entities.
2. Comparison referred to in Clause 1 shall be made on the basis of prices applied by a given entity on a given or comparable market in transactions with unrelated entities (internal price comparison) or on the basis of prices applied in comparable transactions by other unrelated entities (external price comparison).
3. Deemed as comparable may be transactions in which none of the possible differences between the transactions compared or between entities concluding these transactions could have a material impact on the market price of the object of such a transaction or where reasonably accurate adjustments can be made to eliminate material effects of such differences.
4. Where the comparable uncontrolled price method can be applied, this method shall take priority over the other methods defined in the provisions of the ordinance, unless application of another method permits determination of the prices in the transactions at a level closer to the fair market value of the object of such a transaction as well as more accurate determination of the taxpayer's income.

#### **Paragraph 5**

1. The resale price method shall involve reduction of the price agreed in a transaction of a given entity with an unrelated entity, involving goods or services acquired by this given entity from a related entity, by the resale price profit margin. The thus determined price may be deemed the market price set in a transaction of a given entity with a related entity.
2. The resale price profit margin shall include direct expenses and, subject to Clause 3, indirect expenses incurred by a given entity in connection with this transaction plus a profit rate appropriate for this type of transactions. Where, prior to the resale, the entity reprocessed or otherwise changed the value of the object, this change shall be considered for the purpose of the price adjustment referred to in Clause 1.
3. The resale price profit margin shall not include expenses equivalent to the price of the object of a transaction and general administrative costs, that is costs of operating the entity as a whole and costs of managing the entity.
4. The resale price profit margin shall be determined by comparing the margin charged by the same entity in transactions effected with unrelated entities or the margin charged by unrelated entities in comparable transactions.
5. While setting the resale price profit margin, it is necessary to consider the following in particular:
  - 1) factors related to the period of time between the original purchase and the resale, particularly those concerning changes in the market with regard to costs, exchange rates, inflation;
  - 2) changes in the condition and degree of wear and tear of goods constituting the objects of the transactions, including those resulting from technological progress in a given field;

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- 3) exclusive right of the reseller to sell certain goods or rights, which may affect the decision to change the margin.

#### **Paragraph 6**

1. The reasonable margin method (cost-plus method) involves determination of the selling price of objects and rights and provision of services in a transaction of a given entity with a related entity, at a level corresponding to the sum of the costs directly related with the purchase, from an unrelated entity, or own manufacture of the object of the transaction and appropriate profit based on market terms as well as the functions performed by these entities and indirect costs, exclusive of general administrative costs, that is costs of operating the entity as a whole and costs of managing the entity.
2. The reasonable margin shall be determined by comparing the margin charged by the same entity in comparable transactions with unrelated entities or the margin charged in comparable transactions by unrelated entities.

### **Chapter 3 Comparability of Transactions**

#### **Paragraph 7**

1. On establishing comparability of transactions concluded by related entities with transactions concluded by unrelated entities, differences in the characteristic features of products, services or other considerations, which are the objects of the transactions compared shall be taken into account, to the extent that these features can affect the market prices of the objects of the transactions.
2. In particular, the characteristic features of the objects of transactions which affect market prices and are to be taken into account on establishing comparability of the fair market value of these objects in a given market shall be:
  - 1) for tangibles -- physical features, possible pledges of the related rights in favour of third parties; quality, accessibility of goods and related services as well as volume of supply,
  - 2) for intangibles -- duration and extent of protection as well as projected benefits from the use of these goods,
  - 3) for services and other considerations -- type, scope and quality of such services and considerations.

#### **Paragraph 8**

1. On assessing comparability of entities concluding a transaction in a given market, the functions which given entities perform in the transactions compared as well as the business strategy followed shall be taken into account.
2. An analysis of the functions performed by entities involved in a transaction should seek to identify the party which performs economically important functions, that is the functions which are most relevant to generating value and profit from the transaction. Such an analysis should first of all take into account the following:
  - 1) allocation of business risk and liability of the parties to the transaction,
  - 2) volume of funds, machinery and equipment involved,

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- 3) value of intangibles involved.
3. The business strategy referred to in Clause 1 shall imply in particular:
  - 1) discounted prices on entering a new market,
  - 2) temporary reduction of profits to secure higher profits in the long run,
  - 3) higher costs incurred within a definite period to retain the current market position or to gain a new market.
4. Impact of the factors involved in the implementation of a business strategy as declared by an entity may not be taken into account in cases where subsequent activities of this entity prove that a given strategy is not actually being implemented, unless failure to implement such a strategy is due to reasons beyond the control of the entity, which reasons could not be predicted at the time of selecting a given strategy for implementation.

#### **Paragraph 9**

Assessment of comparability of transactions effected on different markets should take into account the conditions on comparable markets to the extent that these conditions affect the prices in transactions concluded on these markets. These shall be in particular:

- 1) size and geographical location of a given market,
- 2) supply-to-demand ratio with respect to given goods or services, consumers' purchasing power and level of competitiveness,
- 3) type and scope of governmental regulation and degree of risk inherent in pursuing activity on a given market,
- 4) production and transportation costs.

#### **Paragraph 10**

1. Comparison of transactions should take into account the terms set in the transactions compared to the extent that differences between these terms may affect the market price of the object of the transaction.
2. Terms of the transactions which may affect the market price of the objects of the transactions compared shall be in particular:
  - 1) terms, conditions and forms of payment,
  - 2) the period within which the transaction is realised,
  - 3) on time realisation of the transaction,
  - 4) hedging of the realisation of the transaction.

### **Chapter 4 Determination of Income Using Transactional Profit Methods**

#### **Paragraph 11**

1. Where it proves impossible to determine income using the methods referred to in Paragraphs 4-6, the transactional profit methods may be applied which involve determination of income on the basis of profit which could reasonably be expected by a given entity participating in a transaction.
2. The transactional profit methods should be applied in such a way as not to increase the tax liability of the entity only because profit generated by the entity is lower than an average profit

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of other entities, where lower profit or failure to generate profit can be attributed to economic or organisational factors.

## **Paragraph 12**

1. On determining the fair market value of the object of transactions effected by related entities, the following transactional profit methods may be applied:
  - 1) the profit allocation method and
  - 2) the net transactional margin method.
2. The profit allocation method involves identification of aggregate profits generated by related entities in a given transaction (transactions) and allocation of these profits to these entities, in a proportion that would have been applied by unrelated entities.
3. Proportional allocation of profits which would be applied by unrelated entities participating in a given transaction (transactions) shall be carried out by:
  - 1) residual analysis in which the sum of profits generated in a given transaction (transactions) is allocated in two stages; in the first stage, each participant of the transaction is allocated minimum profit generated by unrelated entities in that type of transactions; in the second stage, all the profits remaining after the completion of the first stage are allocated between the related entities participating in a given transaction in accordance with the terms which would be agreed by unrelated entities participating in such a transaction; where the sum of profits generated by related entities is lower than the sum of profits allocated in the first stage, the profits allocated shall be reduced; the adjustment made in the second stage shall take into account the economic functions referred to in Paragraph 8 Clause 2, or
  - 2) participation analysis in which the aggregate profit from a transaction involving goods manufactured or improved by these entities is allocated between the entities, on the basis of the relative value of activities undertaken by each related entity, having regard to the factors referred to in Paragraph 8 Clause 2.
4. Allocation of profits referred to in Clause 2 shall be made by appropriate determination of the earnings generated by each related entity and the costs incurred relating to a given transaction (transactions).
5. The net transactional margin method shall involve examination of the net profit margin charged by an entity in a transaction or transactions with another related entity and determination of it at the level of the margin charged by that same entity in transactions with unrelated entities or the margin charged in comparable transactions by unrelated entities.
6. The net transactional margin referred to in Clause 5 shall be determined by deducting from the earnings generated in the transaction of the costs incurred in order to generate those earnings, including general administrative costs.
7. Deduction of general administrative costs referred to in Clause 6 shall be made by taking into account the ratio of the earnings from a given transaction to total earnings.
8. Application of the net transactional margin method shall take into account the differences between the entities whose margins are being compared; in particular the following factors shall be taken into account: competition from other market participants and substitute products, strategy and effectiveness of management, competitive position, differences in costs structures and costs of raising capital as well as business experience.

## **Chapter 5 Special Rules of Determining Fair Market Value of**

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## Intangibles and Services

### Paragraph 13

1. On determining the fair market value of intangibles or services in transactions involving related entities, the tax authorities shall first of all establish whether unrelated, reasonably acting entities would enter into such a transaction under the terms agreed by the related entities.
2. Where reasonably expected benefits (profits) of an entity concluding such a transaction are evidently lower than the expenses involved in this transaction, such expenses may not, pursuant to Article 15 Clause 1 and Article 22 Clause 1 respectively of the laws referred to in Paragraph 1 Clause 1, be recognised as costs of earnings. The provisions of Paragraph 3 Clause 3 shall apply accordingly.
3. On determining the level of expenses referred to in Clause 2, other costs on which the use of a given intangible or service is conditional shall be taken into account.
4. The provisions of Clause 2 shall not apply where a given entity is obligated to undertake a given legal activity pursuant to separate regulations.

### Paragraph 14

1. On estimating income, the tax authorities and the tax inspection authorities shall determine advertising costs incurred by related entities, proportionally to benefits from advertising as generated by these entities. Where one taxpayer incurs the costs of advertising in the benefits of which an entity related to this taxpayer also shares, this first entity should be deemed to provide commercial services to the extent that they correspond, in terms of their nature and scope, to services provided by an unrelated advertising agency.
2. For the purpose of establishing proportionally the expenses for advertising which generates potential benefits for two or more related entities, one should take into account in particular the markets where the advertising is carried on and the share of advertised intangibles and services sold by particular related entities on the markets where the advertising is being carried on.

### Paragraph 15

1. If a taxpayer grants a loan (credit) to a related entity or receives such a loan (credit) regardless of their purpose, or where he grants or is granted a guarantee or a pledge in any form, the market price shall be the interest or the commission which would be agreed by unrelated entities for such a service provided under comparable terms.
2. The fair market value of interest shall be determined on the basis of the lowest interest that a given entity would have to pay to an unrelated entity for a loan (credit) with similar maturity under comparable terms.
3. On determining the value referred to in Clause 2, all relevant circumstances involved in a given case shall be taken into account, in particular:
  - 1) the amount of the loan (credit) and the period for which it has been granted,
  - 2) the character and purpose of the loan (credit),
  - 3) risk involved and security on the loan (credit), having regard to special terms which the lender (creditor) could grant to an unrelated borrower,
  - 4) currency of the loan (credit), risk involved in exchange rates fluctuations, changes in the costs of funds hedging the loan (credit) and funds limiting the risk of exchange rates

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- fluctuations,  
5) the amount of commission.

### **Paragraph 16**

Where one entity related with another entity or with more entities launches research as commissioned by this other entity or entities, possible benefits from the results of the research shall be deemed to accrue to the contractor, for the purpose of determining earnings by these entities from such a transaction (transactions). To determine appropriate compensation for the provision of such services, the method referred to in Paragraph 6 shall apply, regardless of the results of such services.

### **Paragraph 17**

1. Where a taxpayer shares the costs jointly incurred by related entities for the manufacture of intangibles, the level of the cost incurred by the taxpayer may be deemed to have been determined in accordance with the arm's-length principle only where such terms, in light of expected benefits from such sharing, would be approved by unrelated entities.
2. The terms referred to in Clause 1 apply in particular to charging these costs to the entities (in proportion to expected benefits) and, additionally, to allocation of benefits which were not expected (taken into account) on setting these terms (in proportion to the level of considerations).
3. Where a taxpayer has an opportunity to obtain comparable benefits within the agreement referred to in Clause 1, or from an unrelated entity and in either of these cases the taxpayer will incur lower expenses, the lower value shall be taken for the purpose of determining the fair market value of the considerations of this taxpayer.
4. In the cases referred to in Clauses 1-3, the provision of Paragraph 3 Clause 3 shall apply accordingly.

### **Paragraph 18**

1. Where in a transaction (transactions) between related entities the terms agreed are less favourable to one of the entities as compared to the terms which would be agreed by unrelated entities, and at the same time in another transaction (transactions) involving the same entities the terms are agreed which are more favourable to this entity, the tax authorities shall not adjust the prices of the objects of such transactions where lower benefits generated in the first transaction (transactions) are compensated with higher benefits generated in that other transaction (transactions).
2. The compensation referred to in Clause 1 shall be deemed compliant with the arm's-length principle where unrelated entities would make such a compensation.

## **Chapter 6 General Rules Governing Adjustments of Tax Liabilities**

### **Paragraph 19**

1. In order to eliminate double taxation of income of related entities, if income of a taxpayer which is a domestic entity is included, by the tax administration of another state, in the income

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of a foreign entity and taxed accordingly in connection with determination, by this tax administration, of the terms which would be agreed by unrelated entities, the tax office may, at the request of the domestic entity, make an adjustment of the tax liability of this taxpayer, on condition that the relevant international agreements to which the Republic of Poland is a party provide for such an adjustment.

2. The adjustment referred to in Clause 1 may be made by the tax office if the terms determined by the tax administration of this other country are, in light of the provisions of the ordinance, consistent with the terms which would be agreed by unrelated entities.

## **Chapter 7**

### **Final Provision**

#### **Paragraph 20**

The Ordinance shall take effect in 14 days from the date of promulgation.

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