

INTERNATIONAL TAX **CASE SUMMARY**

POLAND vs BEDDING TEXTILES

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ACADEMY OF TAX LAW

PUBLISHING SERVICES

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HEAD OF ACADEMICS



Welcome to the Academy of Tax Law's case and judgment summaries. These documents have been carefully curated to support professionals, students, and researchers navigating the complex landscape of international tax and transfer pricing. At the Academy, we understand that tax law is ever-evolving, with key rulings continuously shaping its practice.

Each summary you'll find here is designed to provide not just the facts, but the context and implications of pivotal legal decisions. These case summaries are created to serve as a valuable resource for legal teams, multinationals, revenue authorities, and academics, offering insights that go beyond the surface. Our goal is to ensure you remain informed and prepared, whether you are dealing with tax planning, dispute resolution, or risk management.

We believe that knowledge is the foundation of sound decision-making, and with these resources, we hope to empower you in your professional journey. As you delve into the analysis, remember that staying ahead in tax law requires not just understanding the rules but how to apply them in a dynamic, global environment.

Thank you for choosing the Academy of Tax Law as your partner in this ongoing learning experience.

Sincerely,
Dr. Daniel N Erasmus

PART 1

SUMMARY

JUDGEMENT SUMMARY

CASE OVERVIEW

Court:	Provincial Administrative Court in Łódź
Case No:	I SA/Łd 592/24
Applicant:	N Sp. z o.o.
Defendant:	Director of the Tax Administration Chamber in Łódź
Judgment Date:	21 November 2024
Full Judgment:	CLICK FOR FULL JUDGMENT
View Online:	CLICK TO VIEW SUMMARY ONLINE

JUDGMENT SUMMARY

The case involves a dispute between N Sp. z o.o. (“the Company”), a Polish textile manufacturer, and the Director of the Tax Administration Chamber in Łódź regarding corporate income tax liabilities for the year 2020. Following a tax audit initiated in February 2023, the first-instance authority concluded that the Company had incorrectly calculated its taxable income, leading to understated costs and revenues. Key issues included transfer pricing adjustments, improper recognition of depreciation expenses, and overstatement of deductible costs related to certain leases.

The Director’s decision, issued on 26 June 2024, adjusted the tax liability from PLN 646,605 to PLN 645,212 while maintaining an additional penalty of PLN 113,320 for unreported income. The Company appealed to the Provincial Administrative Court in

Łódź, alleging substantive and procedural errors, including improper application of transfer pricing rules and unjustified rejection of cost documentation.

The court upheld the Director’s decision, finding that the authorities had adequately examined the evidence and correctly applied tax regulations. The court noted the Company’s failure to substantiate certain expenses and found that the transfer pricing analysis conducted by the tax authorities was consistent with OECD guidelines. However, the court acknowledged partial merit in the Company’s arguments, specifically in the potential recognition of certain costs if properly documented. The judgment underscores the importance of meticulous documentation and adherence to transfer pricing rules for MNEs.

KEY POINTS OF THE JUDGMENT

BACKGROUND

N Sp. z o.o., established in 2012, is a Polish textile manufacturing company specialising in bedding products. The business’s operations focus on fabric production, finishing, and dyeing processes. In February 2023, tax authorities initiated a comprehensive audit for the fiscal year 2020. The audit revealed several discrepancies in the Company’s tax filings, including understated costs and revenues, improper application of depreciation rules, and a failure to meet transfer pricing standards for transactions with related entities.

The key concerns raised during the audit included the improper inclusion of depreciation for machinery funded by government grants and the overstatement of deductible expenses related to leases. In

addition, transfer pricing issues arose, as the operating profit margin for transactions with a related entity was deemed below market standards. These issues culminated in the issuance of an additional tax liability by the first-instance authority. The Company appealed this decision, asserting procedural and substantive errors in the tax authority’s findings.

Despite these claims, the appellate authority upheld the revised tax liability, citing insufficient documentation and failure to align with the arm’s length principle in transfer pricing. This judgment reflects the increasing scrutiny of MNEs’ tax practices in Poland and highlights the critical importance of adherence to local tax laws and OECD guidelines.

KEY POINTS

OF THE JUDGMENT

CORE DISPUTE

The dispute centres on whether N Sp. z o.o.'s 2020 tax filings were compliant with Poland's corporate income tax laws and transfer pricing regulations. The following issues were at the core of the disagreement:

Lease-Related Costs

The Company included substantial lease expenses in its tax-deductible costs. However, the tax authorities contested these amounts, claiming they were not properly documented and did not meet the requirements for deductibility under Polish law.

Depreciation of Machinery

Certain depreciation costs were linked to machinery purchased using government subsidies. These costs were included in the Company's tax-deductible expenses, but the authorities argued that they should be excluded since the assets were fully funded by

grants.

Transfer Pricing Adjustments

Transactions with a related entity featured an operating profit margin of 1.61%, which the tax authorities deemed significantly below the market benchmark of 5.23%. The authorities conducted a transfer pricing analysis, concluding that the reported margin did not meet the arm's length standard and required adjustment.

The Company contended that its practices were in line with market conditions and supported by proper documentation. It further argued that the transfer pricing method and benchmarks applied by the tax authorities were inappropriate. Ultimately, the court's findings sided with the authorities, emphasising the need for thorough documentation and adherence to established guidelines.

KEY POINTS

OF THE JUDGMENT

COURT FINDINGS

The Provincial Administrative Court in Łódź made several critical determinations:

Lease Expenses

The court upheld the authorities' decision to disallow certain lease-related costs, citing a lack of proper documentation. It agreed that these expenses did not meet the criteria for deductibility under Article 15 of the Corporate Income Tax Act.

Depreciation Costs

The court concurred with the authorities that depreciation expenses for machinery funded by grants should be excluded from tax-deductible costs. The rationale was that such assets did not represent a financial burden to the Company, as their purchase was entirely subsidised.

Transfer Pricing

The court supported the upward adjustment of PLN 1,133,197.73 in taxable income, finding that the Company's operating profit margin of 1.61% fell short of the arm's length standard. The authorities' reliance on the Comparable Profits Method (CPM) and their selection of a 5.23% benchmark were deemed appropriate and consistent with OECD guidelines.

While recognising the Company's potential eligibility for certain deductions if adequately documented, the court concluded that the existing evidence was insufficient to overturn the tax authority's findings. This ruling underscores the importance of robust documentation and compliance with transfer pricing rules for MNEs operating in Poland.

KEY POINTS

OF THE JUDGMENT

OUTCOME

The court's decision affirmed the revised tax liability and additional penalty imposed by the Director of the Tax Administration Chamber in Łódź. The Company's appeal was dismissed, with the court concluding that the authorities had acted within the bounds of Polish tax law and adhered to OECD transfer pricing standards.

The judgment highlights the significance of proper documentation in defending tax

positions. Although the court acknowledged potential merit in the Company's claims regarding certain deductions, the absence of adequate evidence ultimately rendered these arguments untenable. This outcome serves as a cautionary tale for MNEs, reinforcing the necessity of meticulous record-keeping and proactive compliance strategies.

TP METHOD

HIGHLIGHTED (IF ANY)

The transfer pricing analysis conducted by the tax authorities employed the Comparable Profits Method (CPM), a widely accepted approach under the OECD Transfer Pricing Guidelines. This method compares the profitability of related-party transactions to that of independent entities operating under similar conditions.

In this case, the authorities identified comparable transactions and established a benchmark operating profit margin of 5.23%. The Company's reported margin of 1.61% was found to be significantly below this benchmark, prompting an adjustment

to align the related-party transactions with market standards. The authorities' functional and comparability analyses were instrumental in determining the appropriate margin.

The CPM's application in this case underscores its effectiveness in addressing pricing discrepancies in controlled transactions. However, it also highlights the challenges MNEs face in substantiating their transfer pricing policies. Proper documentation, including detailed functional analyses and market studies, is critical for defending transfer pricing practices.

PART 2

SIGNIFICANCE

MAJOR ISSUES

AREAS OF CONTENTION

Documentation Deficiencies

The lack of sufficient evidence to support lease-related expenses and depreciation write-offs was a significant point of contention. The court's ruling emphasised the necessity for detailed and accurate records to substantiate tax positions.

Transfer Pricing Analysis

The disagreement over the application of the CPM and the selection of the benchmark margin highlighted the complexities of transfer pricing disputes. The authorities' reliance on OECD guidelines ultimately prevailed, underscoring the importance of adhering to international standards.

Procedural Allegations

The Company alleged procedural errors in the tax authority's handling of the case, including inadequate consideration of its arguments. While the court recognised partial merit in these claims, it concluded that the procedural issues did not materially affect the outcome.

EXPECTED OR CONTROVERSIAL?

The court's decision was expected, given the Company's inability to provide sufficient documentation to support its tax positions. However, the case has broader implications for MNEs operating in Poland. The authorities' reliance on OECD transfer pricing guidelines reflects a growing emphasis on aligning local practices with international standards.

The decision highlights the increasing

scrutiny of transfer pricing practices, particularly in related-party transactions. For MNEs, this underscores the importance of proactive compliance measures and robust documentation. While the court's partial acceptance of the Company's arguments suggests a willingness to consider well-substantiated claims, the outcome ultimately reinforces the need for meticulous preparation.

SIGNIFICANCE FOR MULTINATIONALS

This case underscores the critical importance of compliance with transfer pricing regulations for MNEs. Key takeaways include:

Documentation

MNEs must maintain comprehensive records to substantiate tax positions, particularly for related-party transactions.

Alignment with OECD Guidelines

Adherence to international standards is essential for mitigating tax risks and defending transfer pricing policies.

Proactive Compliance

Implementing robust internal controls and engaging transfer pricing experts can help MNEs navigate complex regulatory environments.

SIGNIFICANCE

FOR REVENUE SERVICES

For revenue authorities, the case highlights the effectiveness of OECD-compliant transfer pricing analyses in addressing base erosion and profit shifting (BEPS). Key lessons include:

Thorough Audits

Comprehensive reviews of taxpayers' filings are essential for identifying discrepancies and ensuring compliance.

Reliance on International Standards

Adhering to OECD guidelines enhances the credibility of transfer pricing adjustments and strengthens enforcement efforts.

Focus on Documentation

Encouraging taxpayers to maintain detailed records facilitates efficient audits and reduces disputes.

RELEVANT CASES

AMAZON VS EU

The European Commission challenged Amazon's transfer pricing arrangements with its Luxembourg-based subsidiary. The dispute centred on whether Amazon had received unfair state aid by shifting profits to a low-tax jurisdiction. The case is particularly relevant to the N Sp. z o.o. case as it underscores the importance of adhering to the arm's length principle in related-party transactions. The decision highlighted the necessity for detailed functional analyses to substantiate the allocation of profits within MNEs, a point also stressed in the Polish court's findings.

[Click here to read the full summary.](#)

APPLE VS EU

This high-profile case involved allegations that Apple's tax arrangements in Ireland constituted illegal state aid. The European Commission argued that Apple's profits were artificially shifted to a "head office" that existed only on paper, resulting in significantly reduced tax liabilities. Similar to the N Sp. z o.o. case, this dispute emphasises the role of proper documentation and compliance with transfer pricing rules to avoid disputes with tax authorities. The parallels include the scrutiny of profit allocations and the use of OECD guidelines to determine compliance.

[Click here to read the full summary.](#)

FIAT FINANCE VS EU

This case addressed transfer pricing issues related to the allocation of profits within Fiat's Luxembourg-based financing company. The European Commission found that the pricing arrangements did not reflect market conditions, leading to an adjustment of taxable income. The relevance to N Sp. z o.o. lies in the shared theme of ensuring that intercompany transactions are conducted at arm's length. Both cases highlight the challenges of defending transfer pricing arrangements without robust documentation and adherence to international standards.

[Click here to read the full summary.](#)

PART 3

PREVENTION

Engaging transfer pricing experts is essential for MNEs to navigate the complexities of international tax regulations. These professionals provide critical guidance on adhering to OECD guidelines and local tax laws, ensuring compliance and mitigating disputes. Experts assist in preparing robust transfer pricing documentation, including functional and comparability analyses, to substantiate intercompany transactions.

Transfer pricing experts also play a pivotal role in conducting proactive risk assessments. By identifying potential weaknesses in an organisation's tax strategy, they can recommend corrective actions to prevent disputes with tax authorities. Additionally, their in-depth knowledge of industry practices and regulatory trends enables MNEs to benchmark their pricing strategies effectively

against market standards.

In contentious situations, transfer pricing experts provide indispensable support during audits and litigation. They help build a compelling case by presenting clear, evidence-backed arguments that align with international standards. Their involvement not only strengthens a company's defence but also demonstrates a commitment to compliance, which can positively influence tax authorities' perception.

Ultimately, engaging transfer pricing experts is an investment in risk mitigation and regulatory adherence. Their expertise ensures that MNEs can confidently navigate the challenges of global tax environments while minimising financial and reputational risks.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX RISK MANAGEMENT PROCESS

To mitigate transfer pricing disputes and ensure compliance, MNEs should implement comprehensive preventative measures. Key steps should include (but not be limited to):

Enhanced Documentation

Comprehensive transfer pricing documentation is critical for defending tax positions. This includes detailed functional analyses, benchmarking studies, and transaction-specific justifications. Ensuring that documentation is updated regularly reflects a proactive approach to compliance.

Training and Capacity Building

Regular training sessions for key personnel can enhance awareness of transfer pricing

requirements and foster a culture of compliance within the organisation.

Conducting Internal Audits

Periodic internal audits help identify discrepancies in transfer pricing practices and rectify them before they attract regulatory scrutiny. These audits should focus on high-risk areas, such as transactions with related entities and jurisdictions with heightened compliance requirements.

Implementing these measures (and more) reduces the likelihood of disputes, aligns MNE operations with global tax norms, and strengthens their defense against potential audits or litigation.

DOWNLOAD FREE BOOK

[TAX INTELLIGENCE: THE 7 HABITUAL TAX MISTAKES MADE BY COMPANIES](#)

Tax Intelligence: The 7 Habitual Tax Mistakes Made by Companies” by Dr. Daniel N. Erasmus is a must-read for businesses seeking to navigate the intricate world of tax compliance and risk management. By highlighting common pitfalls and offering strategic solutions, Erasmus equips companies with the knowledge to improve their tax practices and secure financial stability.

PREVENTATIVE

MEASURES TO AVOID SIMILAR CASES

TAX STEERING COMMITTEE

Establishing a tax steering committee can help ensure that tax policies are aligned with the broader business strategy and that transactions are vetted for both commercial and tax implications. A tax steering committee can:

- Review all significant cross-border transactions before they are executed.
- Ensure that tax decisions are made in the context of overall business objectives, not solely for tax savings.
- Monitor changes in international tax laws to ensure ongoing compliance and avoid disputes like this case.

DOWNLOAD FREE E-BOOK

[DRIVING TAX COMPLIANCE: THE ESSENTIAL ROLE OF THE TAX STEERING COMMITTEE](#)

The eBook “Driving Tax Compliance: The Essential Role of a Tax Steering Committee” by Prof. Dr. Daniel N. Erasmus, Renier van Rensburg, and Gilbert Ferreira, emphasizes the critical importance of establishing a Tax Steering Committee (TSC) within multinational corporations to ensure tax compliance and manage tax-related risks effectively.

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CASE SUMMARY

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