I SA/Ld 592/24 - Judgment

Date of judgment 2024-11-21

Date of receipt 2024-09-06

Sąd Wojewódzki Sąd Administracyjny w Łodzi

Judges Agnieszka Gortych-Ratajczyk /president rapporteur/.

Symbol with description 6113 Corporate income tax

Subject Headings Corporate income tax

Body appealed against Director of the Tax Administration Chamber

Content of the result The complaint was rejected

Cited provisions Dz.U. 2020 no. 0 poz 1406; art. 11c, art. 11d, art. 15 para 1; Act of 15 February 1992 on Corporate Income Tax - i.e. Dz.U. 2021 no. 0 item 1540; art. 58a; Act of 29 August 1997. - Tax Ordinance.

Sentence

Wojewódzki Sąd Administracyjny w Łodzi - Wydział I w składującym: Presiding Judge: Judge WSA Cezary Koziński Judges: Judge WSA Paweł Kowalski Assessor WSA Agnieszka Gortych-Ratajczyk (spr.) Protokolanta: Specialist Agnieszka Kerszner having examined at a hearing on 7 November 2024 a case from the complaint of N Sp. z o.o. z/s in D. against the decision of the Director of the Tax Administration Chamber in Łódź of 26 June 2024 No. 1001-IOD-4.4100.19.2023.19.U71.BRG on determining the corporate income tax liability for 2020 dismisses the complaint.

Justification

By decision of 26 June 2024, the Director of the Tax Administration Chamber in Łódź, having examined the appeal of A. Sp. z o.o. with its registered office in D. against the decision of the Head of the Łódź Tax Office in Łódź dated 14 September 2023, which determined the corporate income tax liability for the tax year from 01.01.2020 to 31.12.2020, in the amount of PLN 646,605.00, established an additional tax liability in corporate income tax for the tax year from 01.01.2020 to 31.12.2020 in the amount of PLN 113,320.00, based on the provision of Article 233 § 1 item 2 letter a of the Tax Ordinance Act of 29 August 1997 (Journal of Laws of 2023, item 2383), hereinafter: the Tax Ordinance Act, repealed the appealed decision in the part concerning the determination of the corporate income tax liability for the tax year from 01.01.2020 to 31.12.2020 and determined the liability in the amount of PLN 645,212.00; upheld the appealed decision in the remaining part.

It follows from the collected case file that on 21 February 2023, following a tax audit, tax proceedings were initiated in respect of corporate income tax for 2020. In the course of the tax proceedings, all the evidence gathered in the case, i.e. the audit protocol with appendices and evidence, the statement of turnover and balances, the accounting records, as well as source evidence in the area of income and expenses, including purchase and sales invoices, also using entries in the form of JPK_KR, were analysed in detail. It was established that Company A. was incorporated under an agreement dated 2 November 2012. In 2020, the partners of the Company were (and still are) M. G., G.G. and J. U.. The actual object of the Company is the production of textile products, finishing of finished products, dyeing of fabrics mainly bedding.

Analysing the results of the conducted activities, the Head of the Łódź Tax Office in Łódź came to the conclusion that the Company in 2020:

1. understated its tax costs by the amount of PLN 21,919.02, representing the difference between the amount of costs resulting from the correction of the CIT-8 return and the amount of costs resulting from the bookkeeping records less expenses which do not constitute tax deductible costs;

2. wrongfully included the amount of PLN 3,983.70, which is the value of depreciation write-offs of fixed assets (textile dyeing machines) to taxable income

3. wrongly recognised as tax deductible revenue the amount of PLN 4,780.49, which is the value of depreciation write-offs for fabric dyeing machines, the purchase of which was reimbursed by the District Labour Office;

4. overstated the tax deductible costs by the total amount of PLN 1,766,278.25, resulting from invoices issued by B. sp. z o.o. sp. k. for the lease of:

a) No. 4/2020 of 30.04.2020, for the net amount of PLN 1,500,00.00 (overstatement of costs by PLN 1,400,000.00),

b) No. 10/2020 of 30.10.2020, for the net amount of PLN 450,000.00 (overestimation of costs by the amount of PLN 350,000.00),

c) No. 11/2020 of 30.11.2020, for the net amount of PLN 200,000.00 (overstatement of costs by the amount of PLN 16,278.25);

5. understated tax revenue by the amount of PLN 1,133,197.73, representing the difference between the income obtained from transactions with a related entity identified in the course of tax proceedings and the income from such transactions disclosed in the CIT-8 return.

In view of the irregularities found, by decision of 14 September 2023. The Head of the Łódź Tax Office in Łódź, pursuant to Article 207, Article 210 § 1, § 2a, § 4 and Article 211, as well as Article 5, Article 6, Article 21 § 1 point 1 and § 3, Article 51 § 1, Article 53 § 1, § 3 and § 5, Article 54 § 1 point 7, Article 55, Article 56 § 1, Article 56c, Article 56d, Article 58a § 1 pt. 4, art. 58b § 1, art. 61b, art. 63 § 1, art. 122, art. 187 § 1 and art. 191 O.p., art. 3 par. 1, art. 7 par. 1 and par. 2, art. 9 par. 1, art. 11a par. 1, par. 2, art. lic par. 1-3, art. 11d (1) (4), art. 12 (1), art. 15 (1), art. 16 (1) (48), art. 17 (1) (21), art. 18 (1) and (1a), art. 19 (1) (1), art. 25 (1) and art. 27 (1) of the Corporate Income Tax Act of 15 February 1992 (Dz.U. of 2020, item 1406 as amended) hereinafter: the A.l.t., § 3(1), § 4, § 5, § 6, § 14 of the Ordinance of the Minister of Finance of 21 December 2018 on transfer pricing with regard to corporate income tax (Dz.U. of 2018, item 2491) determined the party's tax liability in corporate income tax for the tax year from 01.01.2020 to 31.12.2020, in the amount of PLN 646,605 and determined the additional tax liability in corporate income tax for the tax year from 01.01.2020 to 31.12.2020, in the amount of PLN 113,320, representing 10% of the sum of unreported taxable income in whole or in part to the extent resulting from this decision.

In his appeal against the decision of the first-instance body, the proxy of Company A. alleged an infringement of substantive law, i.e. Article 15(1) of the CIT Act by acknowledging that the expenses incurred by the Company do not constitute tax deductible costs due to the fact that they were not incurred in order to achieve revenue or secure or preserve a source of revenue; Article 16(1) of the CIT Act by expanding the catalogue of exclusions from tax deductible costs, while it constitutes a closed catalogue

Moreover, the party's attorney alleged an infringement of procedural provisions that had a significant impact on the outcome of the case, i.e. Article 121 of the P.C. by breaching the principle of conducting proceedings in a manner inspiring trust in tax authorities by formulating conclusions in the decision aimed at proving the thesis adopted in advance; Article 124 in connection with Article 210 § 1 (6) and § 4 of the P.C. by formulating a partial justification for the decision, omitting the justification as to the exclusion from tax deductible costs of some of the expenses questioned by the authority.

In view of the allegations formulated and the authority's actions, the attorney requested, on behalf of the party, that the decision of the authority of first instance be reversed in its entirety and the proceedings in the case be discontinued; alternatively, that the decision of the authority of first instance be reversed in its entirety and the case be referred back to that authority for reconsideration.

By the decision of 26 June 2024 referred to at the outset, the Director of the Tax Administration Chamber in Łódź repealed the appealed decision of the body of first instance in the part concerning the determination of the corporate income tax liability for the tax year from 1 January 2020 to 31 December 2020 and determined the liability in the amount of PLN 645,212.00; for the remainder, he upheld the appealed decision.

The appellate authority, with respect to the understatement of tax deductible costs determined by the first-instance authority by the amount of PLN 21,919.02, constituting the difference between the amount of costs resulting from the adjustment of the CIT-8 return and the amount of costs resulting from the accounting records reduced by expenses not constituting tax deductible costs, indicating the provision of Article 15(1) of the CIT-8 Act, stated that, to the benefit of the party, tax deductible costs for 2020 should be increased by the amount of PLN 21,919.02.

Further, the authority of second instance, quoting the provisions of Article 12(1)(1) and Article 17(1)(21) of the A.p.d.o.p., agreed with the authority of first instance that, due to the fact that the purchase of the fabric dyeing machines was financed by the District Employment Office, the amount of PLN 3,983.70, which constitutes the value of fixed asset depreciation write-offs, should constitute tax-free revenue.

In turn, referring to Article 16(1)(48) of the P.C.P. and the findings of the authority of first instance, the appellate authority approved the exclusion from tax deductible costs, made by the authority of first instance, of the amount of PLN 4,780.49 representing the value of depreciation write-downs on fabric dyeing machines, the purchase of which had been refunded by the District Employment Office. The authority pointed out that the purchase of the fabric dyeing machines was reimbursed by the District Labour Office, the subsidy granted fully covered the amount of the expenditure on the purchase of the machines, and it follows from the depreciation plan for tangible and intangible fixed assets that in 2020 the depreciation write-offs relating to the above machines amounted to PLN 4,780.49 (the amount of PLN 398.37 / month); the above amount was fully booked on the account of costs by type 400 - Depreciation.

Analysing, the reasonableness of the assessment of the body of first instance as regards the overstatement of tax deductible costs by the total amount of PLN 1,766,278.25, resulting from invoices issued by B. sp. z o.o. sp. k. for the lease of:

a) No. 4/2020 of 30.04.2020, for the net amount of PLN 1,500,00.00 (overstatement of costs by PLN 1,400,000.00),

b) No. 10/2020 of 30.10.2020, for the net amount of PLN 450,000.00 (overestimation of costs by the amount of PLN 350,000.00),

c) No. 11/2020 of 30.11.2020, for the net amount of PLN 200,000.00 (overestimation of costs by PLN 16,278.25)

the Appeals Body indicated with respect to the first of the disputed invoices No. 4/2020 that, the net amount of PLN 1,500,000.00 consists of the following values:

- PLN 100,000.00 - charged in accordance with § 5(1) of the lease agreement of 8 August 2016. - rent, which amount was not disputed by the authority

- PLN 1,400,000.00 - by which, according to the authority, the party overstated the tax deductible costs is the amount calculated pursuant to the provision of § 5 item 7 of the aforementioned lease agreement for a one-off event that resulted in the tearing off of the roof of the building, flooding and almost complete destruction of the finishing machine (stabiliser); PLN 1.4 million is, according to the party's explanations, the replacement value of the used stabiliser determined at 1/3 of the price of the value of a new one (PLN 4.5 million). According to the Company, under § 5 point 8 of the above-mentioned agreement, it was possible to issue a single invoice for the entire amount. The price of the new stabiliser was estimated on the basis of trade talks and offers made by machine manufacturers at the ITMA trade fair (fair of machines and equipment for light industry) for a similar machine with similar equipment; therefore, the replacement value of the used stabiliser - by consensus between the owners - was set at 1/3 of the value of the new one, i.e. PLN 1.4 million, and this amount was charged to the lessor with the agreement of the parties, which results, among other things, from the letter of 25 April 2022.

Another disputed invoice No. 10/2020 for the amount of PLN 450,000.00 is the sum of the amount of PLN 100,000 charged pursuant to § 5(1) of the lease agreement of 8 August 2016. - rent, which the authority did not dispute, and PLN 350,000 by which, according to the authority, the party overstated its deductible costs. With regard to this invoice, according to the Company's explanations (the party's letter of 26.01.2022), the aforementioned amount resulted from § 5.7 of the aforementioned agreement of 8 August 2016, i.e. above-normal wear and tear, destruction, devastation related to flooding. According to the party, not only the stabiliser (to which invoice No. 4/2020 relates) was destroyed, but also other equipment and machinery, among others, the steam boiler - steam generator, rotary back dye machine, surfacer with tanks and agitators, water treatment station, racks, tanks with agitators, monitoring cameras, transport tubs, transport trolleys, tanks with agitators.

The appellate authority, indicating the provision of Article 15(1) of the P.C.P. and the position of the judicature developed against this background, agreed with the body of first instance that the party had unjustifiably overestimated the tax deductible costs by the amounts of PLN 1,400,000 and PLN 350,000.

However, according to the authority, the evidence gathered does not confirm that in the event of not incurring the questioned expenses, the entity would lose its source of revenue in the future. Therefore, it is difficult to agree with the attorney that such is the nature of the party's expenses questioned in the decision. In the opinion of the authority, on the contrary, despite unfavourable events (flooding of machines in 2017), the financial situation of the Company did not deteriorate, and, in fact, in 2000 (i.e. the year in which the disputed invoices were issued), it still had the leading position on the Polish bedding fabric market, achieved the highest revenues and its profit increased by 75% compared to 2019. Since the entity's financial situation had not deteriorated (in the three years following the event) but improved, it is difficult, in the authority's view, to agree with the claim that the failure to incur the disputed expenditure in 2020 would contribute to a worsening of the company's financial situation in the future (given that the entity already had a new stabiliser from 2018). In the appellate authority's view, it was the imposition of such high costs that could have contributed to the deterioration of this situation and the consequent loss of the source in the future. The authority

highlighted that, by virtue of the addendum of 31.05.2018 to the lease agreement of 8.08.2016, the company was obliged, in connection with the use of this new stabiliser, to pay an additional rent of PLN 200,000.00 (the machine had cost B. PLN 100,000.00); according to the party's explanations, the amount of the aforementioned rent was included in the amount of PLN 300,000.00 resulting from invoice No. 12/2020 dated 30.12.2020; the disputed decision did not question the expenditure resulting from the aforementioned invoice.

The third of the disputed invoices No. 11/2020 of 30.11.2020, the net amount of PLN 200,000.00 consists of the amount of PLN 100,000.00 - the amount accrued in accordance with § 5 item 1 of the lease agreement; PLN 74,958.00 - property tax; PLN 8,763.15 - insurance costs (after the flooding incident, B. sp. z o.o. sp. k. re-invoiced the cost of property insurance (only buildings and structures). As explained in the letter of 15.06.2022, this amount concerned insurance for 2020. The authority questioned the inclusion in deductible costs of the amount of PLN 16,278.25, which, according to the explanations submitted by the Company (inter alia, in the letter of 26.01.2022), consists of other costs and additional margin for services agreed between the parties. The Appellate Body, pointing to Article 15(1) of the APS, agreed with the party that the amount of PLN 7,333.78 should be considered as a deductible cost. He did not share the party's view regarding the margin in the amount of PLN 8,944.47, because the margin is the difference between the selling price of a given product or service and its production, purchase or delivery cost, the disputed invoice No. 11/2020 was issued for the lease of buildings, machinery and equipment and not for the sale of goods or handling costs. Furthermore, the party did not submit any credible arguments to consider the disputed expense as a tax cost.

Regarding the last disputed issue, transfer pricing, the Appellate Body pointed out that in order to verify whether the terms of the transactions concluded by Company A. with its related party C. sp. z o.o. sp. k. for the sale of products to C. are acceptable as transactions concluded on a free market basis, the authority of first instance: carried out a transfer pricing analysis consisting in comparing the results obtained on transactions concluded between related parties with the results realised by independent entities; established comparability factors in connection with the controlled transaction under examination, and in particular as regards the functions performed, assets used and risks incurred, by all parties involved in the transaction. To this end, the authority prepared a functional analysis of the related parties involved in the transaction, the purpose of which was to detail the course of the controlled transaction and to determine the role played by the Company in creating the economic value of the subject of the transaction. Following the above, the authority of first instance concluded, which was fully accepted by the appellate authority, that the operating profit mark-up on the transaction of sale by the controlled company to a related party in the amount of 1.61% was not a market value; it concluded that the entity violated Article 11c(1) of the A.p.d.o.p. and determined the party's income from the transaction with the related party without taking into account the conditions arising from the links and calculated its amount by increasing the company's tax revenue for 2020 by the amount of PLN 1,133,197.73 according to the calculation: PLN 31,267,365.14 (operating expenses) x 5.23 per cent = PLN 1,635,283.20 (operating profit after re-estimation) - PLN 502,085.47 (operating profit before re-estimation) = PLN 1,133,197.73.

Finally, the appellate authority responded to the charges of the appeal, in extensive argumentation demonstrating their unfoundedness.

In an appeal to the Voivodship Administrative Court in Łódź, the attorney of Company A. challenged the decision of the appeal authority in the part concerning the determination of the tax liability in a different amount due to the failure to take into account the deductible costs indicated by the Company and the determination of the income from the transaction with a related party in a higher amount, as well as with regard to maintaining the decision of the first-instance authority concerning the determination of the additional corporate income tax liability for 2020. The party's attorney alleged:

- violation of the substantive law provisions, i.e.:

1. Article 15(1) of the CIT Act by holding that the expenses incurred by the Company do not constitute tax deductible costs due to the fact that they were not incurred in order to achieve revenue or secure or preserve a source of revenue;

2. Article 11c(2) of the CIT Act through its incorrect application and acknowledgement that the party disclosed lower income to be taxed with income tax due to the alleged non-market determination of terms and conditions of cooperation with a related entity, while the prices agreed between the entities were determined on market terms;

3. Article 11d of the CIT Act by groundlessly questioning the transfer pricing method applied by the Company in the comparative analysis, while the choice of the method and the financial indicator is supported by the OECD guidelines and the Recommendations of the Transfer Pricing Forum;

- Infringement of procedural law provisions affecting the outcome of the case, i.e:

1. art. 58a § 1 O.p.p. by stating that in the case there are prerequisites for the determination of an additional tax liability, while the authority unjustifiably questions the terms of the transactions between related parties, and thus - in the case

there was no understatement of income pursuant to art. 11c.2 of the O.p.d.o.p., which would justify the application of this provision;

2. Article 121 of the C.C.P. by breaching the principle of conducting proceedings in a manner inspiring confidence in tax authorities, consisting in issuing a decision aimed at issuing an unfavourable ruling, disregarding the circumstances favourable for the party;

3. Article 124 of the P.C. by issuing a decision containing illogical conclusions and internally contradictory theses and assumptions, which made it impossible to consider the position of the tax authority as correct and in compliance with the applicable law;

4. Article 127 of the P.C.P. by breaching the principle of two-instance tax proceedings expressed therein, which resulted in a flattening of the proceedings pending before the body of second instance and duplication of the position of the body of first instance, without conducting de facto separate proceedings based on independent findings of the appellate body.

The party's attorney requested that the appealed decision of the body of second instance and the preceding decision of the body of first instance be annulled in part and the case be referred back to the body of first instance for reconsideration, and that the costs of the court-administrative proceedings, including the costs of legal representation be awarded according to prescribed norms.

In response to the complaint, the Director of the Tax Administration Chamber in Łódź, upholding the reasoning of the contested decision, requested that the complaint be dismissed.

The Provincial Administrative Court in Łódź held as follows:

The complaint does not deserve to be taken into account, despite the fact that the applicant's position is partly shared.

The scope of control exercised by provincial administrative courts is defined by the Act of 25 July 2002. Law on the System of Administrative Courts (Journal of Laws of 2021, No. 137, as amended), stipulating in Article 1 § 1 and § 2 that administrative courts exercise the administration of justice by controlling the activity of public administration in terms of its compliance with the law, unless statutes provide otherwise. In turn, pursuant to the content of Article 3 § 1 of the Act of 30 August 2002. Law on Proceedings before Administrative Courts (Journal of Laws of 2023, item 1634, as amended), hereinafter: p.p.s.a., administrative courts control the activity of public administration and apply the measures specified in the law. It follows from the aforementioned provisions that the court examines the legality of the challenged act, whether it complies with the substantive law, which defines the rights and obligations of the parties, and with the procedural law, which regulates the proceedings before the public administration bodies. The court examining the case may not change the contested act, but only accepting the complaint may repeal it, declare it invalid or unlawful, and may do so, pursuant to the regulation contained in Article 145 § 1 p.p.s.a., if it finds a violation of substantive law that affected the outcome of the case; a violation of law giving rise to the resumption of administrative proceedings; another violation of procedural provisions if it could have had a significant impact on the outcome of the case. On the other hand, if the circumstances indicated in Article 145 § 1 do not exist, the complaint, pursuant to Article 151 p.p.s.a., shall be dismissed. Pursuant to Article 134 § 1 of p.p.s.a., however, the court issues a ruling within the limits of a given case, without being bound by the allegations and conclusions of the complaint and the legal basis invoked.

As regards the assessment of the factual state established by the authorities, it should be emphasised that the administrative court does not establish the factual state, but only indicates which findings of the authority were accepted by it and which were not (vide. judgment of the Supreme Administrative Court of 6 February 2008, ref. no. II FSK 1665/06 - available, as well as other judgments of domestic administrative courts cited in this justification, in the Internet Central Database of Administrative Court Judgments at http://orzeczenia.nsa.gov.pl). Assessing the factual state established by the authorities in the case under review in this manner, the Court adopted the factual findings made by the public administration authorities (tax authorities) as the basis for its decision, as the factual state was established in compliance with the rules of administrative procedure.

In the opinion of the Court, in the proceedings of the bodies of both instances, it is impossible to find any infringement of the rules of procedure indicated by the party in the complaint. After a thorough reading of the administrative file of the case and the assessments derived therefrom, the Court came to the conclusion that the circumstances relevant for the decision were sufficiently and reliably established on the basis of the collected evidence, which was assessed in the entirety of the factual and legal circumstances of the case, which in turn allowed a complete picture of the case to be formed. In the course of the proceedings, the party did not submit evidence that would significantly undermine the authorities' conclusions. And, at the same time, the mere fact that each party draws different conclusions from the same evidence does not in itself prove that the other party's arguments are flawed. Nor did the Court find any grounds for upholding the plea that the appellate authority had breached the principle of two instances. In discharging that principle, the appellate body subjected all the circumstances of the case to its own objective assessment, which was reflected in the

arguments set out in the grounds of the contested decision. The fact that the appellate body did not share the appellant's view in the appeal and, in the end, in principle agreed with the findings and assessments of the body of first instance based thereon, does not indicate a breach of the principle in question, which does not oblige the body to re-establish the facts of the case and gather evidence when the facts of the case, as in the present case, have been established in their entirety.

Turning to the merits of the case, it should be emphasised that the Court, bearing in mind the wording of Article 15(1) of the A.l.p., shared the applicant's position that the amounts arising from the disputed invoices No. 4/2020 of 30.04.2020 and No. 10/2020 of 30.10.2020. (amounts of PLN 1,400,000.00 and PLN 350,000.00) could be regarded as tax-deductible costs, however, in the circumstances of this case, such qualification was ruled out by the finding that these costs were not properly documented.

It should be recalled that pursuant to Article 15(1) of the A.p.d.o.p., tax deductible costs are costs incurred to earn revenue or to preserve or secure a source of revenue, except for the costs listed in Article 16(1). The provision of Article 16(1) of the A.p.d.o.p., which was not applicable in the present case, as the authority expressly pointed out in its response to the appeal allegations, contains an enumerative list of exclusions from tax deductible costs.

The cited regulation indicates that the definition of deductible costs, for income tax purposes, consists of two basic elements. The first of these elements may be described as a positive premise, assuming fulfilment of two conditions jointly, i.e. the necessity to actually, as a rule, incur an expense and the fact that the expense must be incurred in order to achieve revenue from a source of revenue or in order to preserve or secure a source of revenue. The second of these elements may be described as a negative premise, according to which the incurred expense is not included in the closed catalogue of expenses not recognised as tax deductible costs, set out in Article 16(1). It is uniformly accepted in administrative court rulings that such expenses whose incurring by a taxpayer was caused by a rational pursuit and objective possibility of achieving revenue (or preserving or securing this source) and which were not listed in Article 16(1) of the A.P.C. should be regarded as tax deductible costs (cf. resolutions of the panel of seven judges of the NSA: of 24 January 2011, ref. no. II FPS 6/10; of 25 June 2012, ref. no. II FPS 2/12).

The phrase ‘for the purpose’ used in the cited provision means that not every expense incurred by a taxpayer in connection with his/her business activity is deductible from the tax base, but only the expense which remains in a causal relationship with revenue. The expense must be assessed having regard to the rationality of a specific action to achieve revenue. The incurring of the expense must therefore be connected with the business activity conducted by the taxpayer, aimed at obtaining revenue. The expense should, at least potentially, affect the amount of revenue obtained or expected to be obtained from that activity. The cost qualification of a particular expense for a particular taxpayer must, therefore, take into account the nature and profile of the business activity conducted and the economic rationality of the expense incurred (cf. the judgments of the Supreme Administrative Court: of 16 October 2012, file ref. no. II FSK 430/11; of 5 January 2022, file ref. no. II FSK 3006/19).

In summary, as should be deduced from the provisions of the Corporate Income Tax Act and as confirmed by the jurisprudence of the administrative courts, in order to recognise an expense as a tax deductible cost:

- the expense must be definitively made,

- the expense must be aimed at generating revenue or, alternatively, at preserving or securing a source of revenue,

- the expense should be related to the taxpayer's business activity; and

- the expense should be properly documented.

and is not included in the group of expenses which, pursuant to Article 16(1) of the A.P.C., are not deemed to be tax deductible costs. A taxpayer, who is obliged to document the fact of incurring the given expenditure in a lawful manner in a manner that does not raise any doubts, and who did not fulfil the obligation to properly document the expenditure, must take into account the negative consequences of such conduct.

In view of the above, the Court shares the applicant's view that the expenditures incurred by the party in the face of invoices of PLN 1400,000 and PLN 350,000 issued by the Company B. were incurred in order to maintain the source of revenue. These were expenses incurred in order for the revenue from a given source of income to continue intact and for such source to continue to exist at all. It cannot be overlooked, as is evident from the established facts, that the applicant conducts its business activities in the leased buildings and with the use of the leased equipment, it is therefore consistent that the incurring of the charges imposed on the party with the consent of both parties to the agreement, pursuant to the provision of § 5(7) of the lease agreement of 8 August 2016 binding the parties, is in connection with the business conducted. There is also no doubt that they were incurred for the purpose of preserving the source of revenue, as it cannot be overlooked that the lessor is entitled to terminate the contract in the event of default in the payment of rent or

other charges under the contract, including those charged pursuant to the provision of § 5(7) of the contract, which is apparent from the provisions of the contract.

In the view of the authorities, the disputed expenses were incurred accidentally and resulted from the negligence of the party who, being obliged, it follows from the said lease agreement, to insure the object of the lease, waived this obligation; the fees charged are therefore, in the authorities' view, the consequence of the party's negligence. In the Court's view, the authorities attach too much weight to the finding that the party failed to comply with the obligation to insure the leased property, which resulted in an 'additional charge'. It should be noted that the provision of § 5(7) of the aforementioned lease agreement in no way refers to the failure to comply with the obligation to insure as a circumstance resulting in the charging of such a fee. Therefore, it is not excluded that even if the party had insured the object of the agreement, B. would not have charged such a fee on the basis of the mentioned § 5(7) of the aforementioned agreement, as this provision entitles to impose an additional fee with the consent of the parties in justified cases such as excessive wear and tear, destruction, devastation, etc. Therefore, it cannot be ruled out that we would be dealing with a situation where both compensation is paid and a fee is imposed, as the two grounds are not mutually exclusive and are not dependent on each other, as can be inferred from reading the authority's arguments.

However, despite accepting the party's position in this respect, the Court of First Instance dismissed the application as it was convinced that the expenses incurred were not properly documented.

On the basis of Article 15(1) of the CIT Act, the court rulings have established the position that in order to recognise an expense as a deductible cost, it is also necessary to properly document this operation. It is up to the taxpayer to demonstrate that the conditions for recognising a given expense as a tax deductible cost are met. The taxpayer may not pass the burden in this respect onto the tax authorities, while the lack of proper documentation leads to questioning of the tax deductible costs. When an event has not been documented and, at the same time, it is not possible to reconstruct the facts, it should be assumed that it is not possible to determine tax deductible costs (e.g.: judgments of the NSA: of 1 June 2016, ref. no. II FSK 1399/14; of 24 May 2016, ref. no. II FSK 1241/14; of 11 March 2016, ref. no. II FSK 96/14).

The recognition of a given expense as a tax deductible cost is possible only if it is clear beyond any doubt from correctly and reliably documented events that it is a purposeful and reasonably justified expense. It is not clear from the administrative file of the present case whether the invoice for PLN 350,000 was established in view of the consensual assumption that the equipment was destroyed (to which the authority is inclined), or whether, as the party's attorney argued at the hearing, there was excessive wear and tear. In addition, there are no documents, following analysis of which it would be possible to verify the list of equipment and the data indicated by the party's attorney in the table presented in the letter of 25 April 2023, such verification cannot be made on the basis of the appendices attached to the aforementioned letter, if only due to the fact that they do not refer to all the equipment listed in the list in tabular form, are illegible and are mostly printouts of photographs, from which the contents necessary for the aforementioned analysis do not appear. There are no source documents showing whether the equipment was new or used and, if so, for how long it was used until it was found to have been destroyed or worn beyond repair. What their destruction consisted of and, finally, how the parties determined that there was above-normal wear and tear, what data formed the basis for these determinations. There are no documents in the case file, after analysis of which these doubts could be dispelled. There is no damage report, photographic or descriptive documentation. The party explained that it had repaired the equipment, but it is not clear to what extent and what impact this had on the final assessment as to the destruction or above-normal wear and tear. The written explanations of the party's attorney or the explanations of the parties to the lease agreement, which cannot be verified in any way, are not sufficient.

In the opinion of the Court, the expenditure of PLN 1,400,000 was not properly documented either. The submission of a single offer for a stabiliser and the party's statement, which is not supported by any documents, that the price of a new stabiliser was estimated on the basis of trade talks and offers made by machine manufacturers at the ITMA trade fair (machinery and equipment trade fair for the light industry) for a similar machine with similar equipment, and therefore the replacement value of a used stabiliser - by consensus between the owners - was set at 1/3 of the value of a new one, are insufficient in terms of proper documentation. It is clear from the party's explanation that the stabiliser was not new, which influenced the party's assumption of its value at 1/3 of the value of new, but it is not clear how old the machine was, how the repairs made after the storm influenced the determination of the replacement value. It is also not clear from the case file whether the stabiliser was destroyed, whether it was over-used and what news, data, documents entitled to such conclusions.

For all these reasons, in the Court's assessment, one has to agree that the discussed expenses could be recorded as tax deductible pursuant to Article 15(1) of the CIT Act, however, due to their lack of proper documentation, this is excluded. The party's declarations with regard to the aforementioned expenses are not subject to any verification due to the lack of documents which could be appropriately analysed by the authority. Thus, there is no evidence to verify the connection of the expenditure with the party's income. In addition, when analysing the above, it should be borne in mind that we are dealing with related entities, which should take care of the transparency of cooperation all the more so.

Undoubtedly, the mere incurrence of expenses is not sufficient to include them as tax deductible costs. The reduction of revenue by the incurred costs is not an obligation, but a right of the taxpayer, which depends on proving that they were incurred in order to achieve revenue. It is the correct documentation of the costs - which was missing in the case - that allows to determine whether the statutory prerequisites allowing to recognise a given expense as a tax deductible cost within the meaning of the Tax Act were met. Consequently, it is of fundamental importance that the costs incurred are properly documented, as it is in this way that it is possible to demonstrate (establish) that the statutory prerequisites allowing for the recognition of a given expense as a tax deductible cost within the meaning of the cited provision are met.

Turning to the third of the disputed invoices, No. 11/2020 of 30.11.2020, for the net amount of PLN 200,000.00, the Court shares the assessment of the appellate authority which, indicating the provision of Article 15(1) of the A.P.P., regarded as credible the party's claim that the amount of PLN 7,333.78 results from the reinvoicing of costs incurred for property insurance, and therefore recognised this amount as a tax deductible cost, while at the same time stating that the party overstated the costs by the amount of PLN 8,944.47. In a letter dated 15.06.2022, the party explained that the indicated amount of PLN 8,944.47 was a margin. The authority, having regard to the party's explanations in this regard and the findings made, indicated that the margin is the difference between the selling price of a product or service and its cost of production, purchase or delivery, and that invoice No. 11/2020 of 30.11.2020 was issued by the company B. for the lease of buildings, machinery and equipment and not for the sale of goods or handling costs. Moreover, the party did not submit any additional documents regarding the alleged margin, nor did it present any credible arguments allowing the disputed expense to be considered a tax cost. In the opinion of the Court, the position of the authority on the above issue deserves to be approved, and the different classification of the disputed expense only at the complaint stage, where the party indicates that these are expenses on account of handling costs for outstanding interest due to untimely payment of invoices, does not affect the outcome of the case.

When reviewing the contested decision as regards the further shortcomings found by the authorities, in the Court's view, the factual and legal circumstances and the reasoning of the authorities, which the party has not disputed both in the appeal and the application, do not give rise to any doubts. The Court shares the view that the applicant understated the tax costs by the amount of PLN 21,919.02, constituting the difference between the amount of the costs resulting from the correction of the CIT-8 return and the amount of the costs resulting from the bookkeeping records reduced by expenses not constituting tax deductible costs. Similarly, the finding that the applicant unjustifiably included the amount of PLN 3,983.70, representing the value of depreciation write-offs of fixed assets (fabric dyeing machines), in taxable income. The authorities correctly deduced that in view of the fact that the purchase of the machines was financed by the District Labour Office, the above amount should constitute tax-free revenue.

Contrary to the party's position, in the court's opinion, the appellate authority's assessment as to the unjustified inclusion in tax deductible costs of the amount of PLN 4,780.49, being the value of depreciation write-offs relating to fabric dyeing machines, the purchase of which was refunded by the Poviat Employment Office, is also correct. As to this issue, having regard to the allegations of the appeal, the body of the second instance made additional findings reaching conclusions deserving to be shared that it is not disputed that in 2014 the Company purchased, with the financial support of the District Labour Office in P., two fabric dyeing machines, each for the amount of PLN 17,073.17; in July 2014. District Labour Office transferred the amount of PLN 42,000.00 to the Company's account; The total amount of depreciation of the machines in 2020 was PLN 4,780.49 and was booked in the account of costs by type: 400 - depreciation and the Company, following the rules under the Accounting Act, booked the depreciation write-offs on the above-mentioned machines in deductible costs. As the Appellate Body rightly pointed out, there is no documentation in the documents of the present case confirming the party's statement that the party reimbursed to the District Labour Office the amount corresponding to the equivalent of CIT. In view of the foregoing and, moreover, in view of the provisions of Article 16g(1)(1) of the Corporate Income Tax Act, the first instance authority was justified in excluding the amount of PLN 4,780.49 from tax deductible costs.

The last of the faults found by the authorities, consistently questioned both in the appeal and in the complaint, concerns the decision as to whether the party understated its tax revenue by the amount of PLN 1,133,197.73, constituting the difference between the revenue from transactions with a related entity, the C. company, and the revenue from these transactions disclosed in the CIT-8 return.

Pursuant to Article 11c(1) of the A.P.C., related parties are obliged to determine transfer prices on terms that unrelated parties would determine between themselves. Transfer prices - pursuant to Article 11d(1) of the aforementioned Act - shall be verified using the most appropriate method in the given circumstances, selected from the following methods:

1) comparable uncontrolled price;

2) resale price;

3) cost-plus;

4) net transaction margin;

5) profit sharing.

In order to verify whether the terms and conditions of the transactions concluded by a party with a related party for the sale of products to C. are acceptable as transactions concluded on a free market basis, the authorities carried out a comparative analysis of the pricing methods in transactions between related parties with those carried out by independent parties. Based on external databases, i.e., inter alia, the CEIDG application, the REGON search engine, the D. company website, the National Court Register (online version), the authority identified 8 entities carrying out activities comparable to the party, finally, for the analysis it adopted four entities indicating their characteristics comparable to the party, taking into account the business profile, for the study it adopted the period from 2015-2019. For the verification of transactions it selected the net transaction margin method, considering it the most appropriate, taking into account: the type of transaction documented, functional analysis, as well as the availability of financial data. For the purposes of the financial analysis, he used the ratio of the mark-up to operating expenses - the operating mark-up, calculated according to the formula: operating profit (loss) x 100% / operating expenses (according to the authority's calculation, Company A. achieved an operating profit ratio of 1.61% in 2020).

As a result of the analysis and the results obtained, the authority found that the interquartile range for the transaction under review is between 4.20% and 9.22% with a median of 5.23% (after rejecting extreme results). The authority - taking into account the assets involved by the company, the risks incurred, the access to capital, the way the company is managed - assumed that the amount of the operating mark-up in transactions to a related party that most closely approximates market value is the value corresponding to the median of 5.23%. Taking into account the arm's-length principle, as well as the scope of A.'s functions, the assets involved and the amount of risk taken, while comparing the prices resulting from the analysis), he concluded that an operating profit mark-up of 1.61% on a sale by a controlled company to a related party was not market value. Consequently, it found a breach by the party of Article 11c(1) of the A.P.C. and, pursuant to the provision of Article 11c(2) of the A.P.C., determined the party's income from the transaction with the related party without taking into account the conditions arising from the relationship and calculated its amount by increasing the Company's tax revenue for 2020 by PLN 1,133,197.73.

In the Court's opinion, the calculations presented by the tax authorities and the methods applied do not raise any doubts, and the reasoning in this respect, as well as the justification of the groundlessness of the appeal allegations in this respect, deserve approval.

Having regard to the party's allegations, it should be briefly pointed out that, when selecting the most appropriate method in the given circumstances, particular consideration shall be given to the conditions which have been established or imposed between related parties, the availability of information necessary for the correct application of the method and the specific criteria for its application - as indicated by paragraph 3 of the aforementioned Article 11d of the Act.

In turn, in accordance with § 14(4) of the Ordinance of the Minister of Finance on corporate income tax transfer prices: the selection of an appropriate financial indicator is made taking into account the specifics of the industry (i.e. the subject of the business) and the relevant circumstances of the transaction. In the present case, the authorities reasonably took into account that the functional analysis showed that the applicant Company in the examined transaction performs functions typical of a producer and not of a distributor or agent. Which justifies the omission of the indicator indicated by the party, i.e. the net sales mark-up indicator. In doing so, it should be highlighted that the legislator only indicates that: transactions (accepted for examination) entered into by independent parties are to be comparable to those entered into by related parties, not identical. Similarly, the base: it is to be consistent and comparable, not identical. As regards the indicator cited by the party as correct for the transactions in question: the net sales mark-up, the authority correctly pointed out that this is an indicator to assess the mark-up applied in transactions between related parties for distributors and sales agents in relation to the purchase price (and not producers). The functional analysis showed that the complainant Company in the transaction under examination performs functions typical of a producer and not of a distributor or agent. Different economic indicators will apply to a trader that is a producer, others to a trader that is a distributor, still others to a seller or service provider.

Consequently, the determination under Article 58a § 1(4) of the CIT of an additional corporate income tax liability in connection with the issuance of a transfer pricing decision is justified, as the terms and conditions of the transaction between related parties in the present case were not determined on an arm's length basis.

It is worth quoting at this point the statement of the Supreme Administrative Court, which, in the judgment of 20 June 2018, ref. no. II FSK 1665/16, emphasised that the purpose of the special legal regulation under Article 11c of the A.l.t.c. is to secure the interests of the State Treasury against such actions of taxpayers which consist in applying prices in mutual transactions that deviate from the market in order to achieve a tax result that is favourable to themselves. The prerequisite for the application of Article 11c of the A.p.d.o.p. is not the mere fact of the occurrence of links, between the parties to the transaction, but the use of these links to change the level of taxation (tax evasion). At the basis of the

regulation contained in this provision is the assumption that all transactions should comply with market conditions, i.e. conditions that would be agreed upon by independent entities in the same or similar situation.

Taking into account all the above circumstances, the Court assessed that the authorities did not infringe the provisions of substantive law, nor the provisions of procedural law to the extent that influenced or could influence the outcome of the case, in particular the allegations raised in the complaint are not justified, and this means that the complaint, pursuant to Article 151 p.p.s.a., is subject to dismissal.

AKE.