

Tax & Legal Alert

Corporate Income Tax

Poland, August 2011

Contact

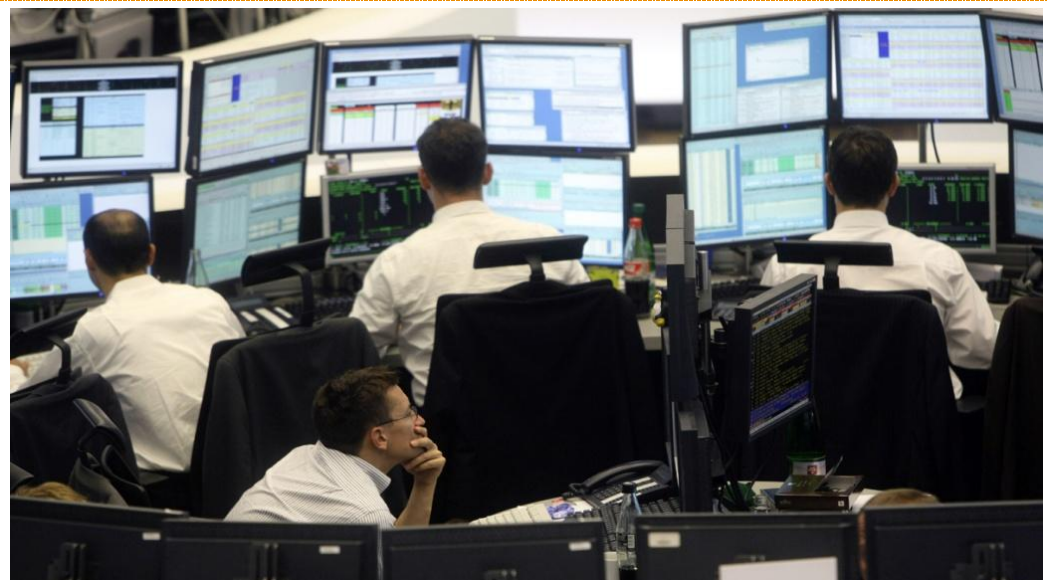
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Tax & Legal Department.***



On 21 July 2011, the Regional Administrative Court in Warsaw (“Court”) issued a favourable judgment with respect to tax deductibility of costs of contractual penalties (ref. III SA/Wa 2735/10).

Please note that our alert is based on the verbal justification of the judgment since the written one has not been published yet. Any decisions should be based on the written justification of the judgment.

Contractual penalties may be treated as tax deductible costs

The Court stated that contractual penalty may be treated as a tax deductible cost for Corporate Income Tax (“CIT”) purposes, if the Company incurred it for the purpose of generating revenues or securing a source of revenues.

Background

The Company was the leader of a consortium which concluded a contract to build an urban football stadium. During realization of the investment, the contract was terminated because of a delay with respect to the construction schedule. In consequence, the Company was charged with contractual penalty.

As a result of negotiations, an agreement between the Company and the city authority was concluded. According to the above agreement, a lower amount of contractual penalty was agreed. At the same time, the Company secured the possibility to generate revenues in the future from sales of the technical infrastructure elements and it secured its right to participate in public tenders organized by the city authority.

In the light of the above background, the Company had doubts about the treatment of the above expenditure as tax deductible costs. The Company submitted an application for an individual interpretation of the tax law to confirm that it was entitled to recognize the contractual penalty as tax deductible cost. In the Company's opinion, it should be entitled to recognize the tax deductible cost, since Art. 16 section 1 point 22 of the CIT Act excludes only contractual penalties related to defects of goods delivered, work and services performed and a delay in delivering defect-free goods or a delay in eliminating defects of goods or work and services performed. In addition, by paying the penalty, the Company secured its positive image and did not exclude the possibility to participate in public tenders in the future. The tax authority did not agree with the Company's standpoint. The Company appealed against the negative tax ruling to the Court.

The conclusion of the judgment

The Court stated that since the Company obtained revenues during the realization of the contract and subsequent revenues should be generated after termination of the contract, the Company's course of action after termination of the contract (paying the contractual penalty), was rational and aimed at the purpose of generating revenues.

In addition, in the Court's opinion, Art. 16 section 1 point 22 of the CIT Act (which excludes certain contractual penalties from tax deductible costs) regards services which have been already performed, not those, which are in the process of being performed (like in the case at hand).

In light of the above, the fee incurred by the Company may be treated as the deductible cost for CIT purposes.

Should you be interested in obtaining further information on the outlined issues and their implications please contact Rebeka Weintraub-Filek, tel. + 48 71 356 11 52, rebeka.weintraub-filek@pl.pwc.com.

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