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REPORT

From: General Secretariat of the Council
To: Permanent Representatives Committee/Council

Subject: Code of Conduct Group (Business Taxation)
– Report to the Council
= Endorsement

Poland's IP regime (PL012)

I/ AGREED DESCRIPTION

The following description was agreed by the Code of Conduct Group on 27 February 2019:

Country		Country name
“ (1. Please provide below the basic information about your regime	a. Name of the regime	Preferential taxation of income derived from intellectual property rights so called “IP Box” (Article 24d and 24e of the Act of 15 February, 1992 on Corporate Income Tax, CITA (Journal of Laws from 2018, item 1036 with subsequent amendments)
	b. Year of introduction/relevant legislation	2018 (as of 1 January 2019)
	Year	Attachment to the questionnaire
	Please attach to this template (or provide a link to) the legislation which introduces your new IP regime (if in a language other than English or French, please provide a translation.)	

Country	Country name
c. Benefits under your regime (e.g. a reduced rate or a deduction, an exception, or some other reduction in the taxable base)	Benefits under the Polish IP BOX regime are granted by providing the preferential taxation with the reduced 5% corporate income tax rate with reference to income derived from the qualified intellectual property rights.
d. Effective tax rate under your regime	5%
e. Statutory rate in your jurisdiction that would apply in the absence of the regime	19%
f. Stated purpose of your regime	<p>The main purposes of the Polish IP BOX regime are:</p> <ul style="list-style-type: none"> • retaining and increasing the attractiveness of conducting R&D activity by Polish and foreign entrepreneurs, • encouraging new/potential entrepreneurs to undertake R&D activity in Poland, • changing the economic model into a knowledge-based economy, and • creating high-quality jobs in innovative/R&D sectors.
2. Please describe the scope of qualifying taxpayers under your regime.	<p>Qualifying taxpayers are those taxpayers who create, develop or improve the subject of protection of qualified intellectual property rights as a part of their R&D activity, whose income from qualified IP rights is liable to taxation in Poland.</p>
3. What types of IP assets can qualify for benefits under your regime?	<p>According to the provisions on the Polish IP BOX [Article 24d paragraph of the CITA], the qualified IP rights are as follows:</p> <ul style="list-style-type: none"> • patent, • protection right for utility model, • rights in registration of industrial design, • rights in registration of the integrated circuit topography, • supplementary protection certificate for patent for a medicinal product or plant protection product, • right in registration of the medicinal and veterinary product admitted to trading, • the exclusive right set out in the Act on legal protection of plant varieties,

Country		Country name	
		<ul style="list-style-type: none"> copyright to a computer program <p>The provisions also apply to the expectancy right of receiving the qualified IP right (the IP right is not legally protected yet and is in the process of application to obtain a relevant protection right) from the date of submission of the application [Article 24d paragraph 12].</p> <p>In case of withdrawal of the application, refusal to grant a protection right of protection or rejection of the application, the taxpayer is obliged to pay tax on the qualified income earned in the period ranging from the date of the submission of the application to the date of withdrawal of the application, or refusal to grant a protection right, or rejection of the application, in accordance with the general rules, i.e. subject to 19% tax rate. In this case, the tax paid in accordance with the reduced tax rate (5%) is deducted from the tax calculated in respect of the total amount of income according to general rules (19%). [Article 24d paragraph 13]</p> <p>The IP regime also applies to the taxpayer's income from exclusive licenses to use the qualified IP right, provided that the taxpayer has previously carried out R&D activity which resulted in a qualified IP right. [Article 24d paragraph 14]</p>	
4. Third category of IP assets	a. Are you planning on allowing the third category of IP assets described in paragraph 37 of the Action 5 Report to qualify for benefits?	Yes/no	No
		(i) Please describe how you will limit the taxpayers benefiting from the third category.	-
		(ii) Please describe what IP assets will qualify under this category, and the reason why they will fit with the specific requirements in paragraph 37 of	-

Country		Country name
		the Action 5 Report.
		(iii) Please describe the transparent certification process (undertaken by a competent government agency that is independent from the tax administration) under your regime.
		(iv) Please describe the procedures you have implemented to ensure annual reporting to the FHTP and spontaneous exchange of information.
5. What income will qualify for benefits? Please describe how you are ensuring that the amount of income is not equal to the gross income from IP assets.		<p>The definition of qualifying income that benefits for IP regime is specified in the Article 24d paragraph 7. According to the provision the income earned from qualified intellectual property rights (IP income) is the income earned by the taxpayer in the tax year:</p> <p>1) from royalties or other fees related to qualified intellectual property rights,</p>

Country	Country name
	<p>2) from the sale of qualified intellectual property rights;</p> <p>3) from the qualified intellectual property right included in the selling price of the product or service;</p> <p>4) from compensation for infringement of rights resulting from a qualified intellectual property right obtained in litigation, including court proceedings or arbitration.</p> <p>This income is calculated in accordance with general rules set out in the Act on Corporate income tax i.e. income = gross income – tax deductible costs [Article 7 paragraph 1]. As a consequence of such calculation the IP income can never be the gross value.</p> <p>In addition the Polish IP regime permits the taxpayer to apply the 30% “up-lift” to the qualified expenditures (as placed in the counter of the below depicted formula). But the value of the nexus ratio is always limited to 1. Hence, if the value of the ratio is greater than 1, it is always assumed to be 1. [Article 24d paragraph 6]</p> <p>According to the Article 24d paragraph 4 the amount of the qualified income earned from qualified intellectual property rights that benefits for the reduced 5% tax rate is a value calculated as the product of income earned from qualified intellectual property rights and the ratio calculated according to the formula:</p> $\frac{(a + b) * 1,3}{a + b + c + d}$ <p>where each letter means expenses actually incurred</p>

Country			Country name
			<p>by the taxpayer on:</p> <p>a - research and development activities undertaken by the taxpayer and related to qualified intellectual property right,</p> <p>b- the acquisition of the results of research and development works related to qualified intellectual property right other than those listed in the letter d, from an unrelated party</p> <p>c- the acquisition of the results of research and development works related to qualified intellectual property right other than those listed in the letter d, from a related party.</p> <p>d – the acquisition of qualified intellectual property right by the taxpayer.</p> <p>This reflects the “nexus ratio” as depicted at the OECD’s Report on BEPS Action 5 at paragraphs 43 and 44.</p>
6.	a. Does your regime allow embedded IP income to qualify for benefits?	Yes/No	Yes [Article 24d paragraph 7 subparagraph 3]
	b. If yes, please describe how you are ensuring that non-IP income (e.g. marketing and manufacturing returns) does not also qualify for benefits.		<p>The Article 24d paragraph 7 refers to the types of income that can benefit from the IP regime and clearly states that one of the type of the IP income earned by the taxpayer in the tax year is the income from the qualified intellectual property right (IP income) included in the selling price of the product or service.</p> <p>In Polish IP BOX regime, the calculation of the amount of income derived from qualified IP rights is based on transfer pricing principles and this rule is specified in the Article 24d paragraph 8 which refers to the Article 11c of the CITA, the newly</p>

Country			Country name
			modified, very robust transfer pricing provisions, in force from 1 January 2019.
7. Tracking and tracing	a. Have you designed tracking and tracing requirements to ensure that income that is not from qualifying IP assets or that is not qualifying IP income does not qualify for benefits?	Yes/No	Yes
	b. If yes, please describe your regime's tracking and tracing requirements.		<p>In accordance to the provisions [Article 24e] the taxpayers are obliged:</p> <p>1) to identify each qualified intellectual property right in the kept accounting records;</p> <p>2) to keep accounting records in a way that ensures determination of revenues, tax deductible costs and income (loss) attributable to each qualified intellectual property right;</p> <p>3) to identify the costs referred to in paragraph 4, for each qualified intellectual property right, in a way that ensures the determination of qualified income;</p> <p>4) to make entries in the kept accounting records in a manner ensuring the determination of the total income from these qualified intellectual property rights - in case when the taxpayer uses more than one qualified intellectual property right, and it is impossible to meet conditions referred to in points 2 and 3 in the kept accounting records;</p> <p>5) make entries in the kept accounting records in a way that ensures determination of the income from</p>

Country	Country name
	<p>qualified intellectual property rights for a product or service, or for those products or services, if the taxpayer uses one or more of the qualified intellectual property rights in the product or service or in products or services, and it is not possible to meet the conditions referred to in points 2-4 in the kept accounting records.</p> <p>The costs referred to in paragraph 4 means expenses actually incurred by the taxpayer on:</p> <ul style="list-style-type: none"> - research and development activities undertaken by the taxpayer and related to qualified intellectual property right, - the acquisition of the results of research and development works related to qualified intellectual property right other than those listed in the letter d, from an unrelated party - the acquisition of the results of research and development works related to qualified intellectual property right other than those listed in the letter d, from a related party - the acquisition of qualified intellectual property right by the taxpayer. <p>The word “acquisition” actually refers to “outsourcing” in the sense that it refers to R&D contracts in a situation where the taxpayer outsources the R&D activities to related or unrelated parties. Consequently, by “acquisition” the legislation actually means “outsourcing” as used in the OECD’s Report on BEPS Action 5, paragraphs 49-51.</p>
<p>8. Please explain how losses associated with the IP income will be treated under your regime. The explanation should include how your regime ensures that the requirement under footnote 14 to paragraph 47 of the Action 5 Report is met.</p>	<p>The treatment of losses under the Polish IP BOX regime is specified in the Article 24d paragraph 10 and it determines the separate loss method.</p> <p>The income related to qualified intellectual property right, or the same type of product or service in which qualified intellectual property right has been used, shall be reduced – in 5 subsequent tax years - by the amount of the loss from qualified intellectual property right incurred in the tax year. This means that IP losses can only be off set against the IP income.</p>

Country			Country name
			As a consequence, IP losses are always kept separated from the ordinary income and cannot be off set against the taxpayer's ordinary income even if there is no IP income against which to use the losses. But they may be carried forward to be used against future IP income (in 5 subsequent tax years).
9. If you are not a Member State of the European Union, have you designed your regime to be consistent with footnotes 16 and 19 on page 42 of the Action 5 Report?			Poland is a Member State of the European Union.
10. Related-party outsourcing	a. Does your regime limit benefits based on outsourcing to related parties?	Yes/No	Yes
	b. If yes, please explain how your regime limits benefits based on outsourcing to related parties.		<p>The Polish IP BOX regime limits benefits in case of outsourcing of the R&D activities to related parties.</p> <p>Expenses incurred by the taxpayer on the acquisition of the results of research and development works related to qualified intellectual property right from a related party are placed in the denominator of the ratio (nexus ratio) used to calculate the qualified income from IP rights and as the consequence they decrease the total amount of qualified income that benefits from the reduced tax rate. [Article 24d paragraph 4]</p>
11. Acquisitions of an IP asset	a. Does your regime limit benefits based on acquisitions?	Yes/No	Yes

Country		Country name	
	<p>b. If yes, please explain how your regime limits benefits based on acquisitions. Following this question, please proceed to Question 13.</p>	<p>The Polish IP regime limits benefits in case of acquisition (outsourcing) of the qualified IP right.</p> <p>Expenses incurred by the taxpayer on the acquisition (outsourcing) of qualified intellectual property right are placed in the denominator of the ratio (nexus ratio) used to calculate the qualified income from IP rights and as the consequence they decrease the total amount of qualified IP income that benefits from the reduced tax rate. [Article 24d paragraph 4]</p> <p>Moreover benefitting from the regime is possible only if the taxpayer create, develop or improve the subject of protection as a part of his research and development activity. Therefore if the taxpayer buys the IP right and does not undertake R&D activity related to that right, the income derived from that IP asset cannot qualify for the regime. [Article 24d paragraph 2]</p>	
12. Related-party outsourcing and acquisition of an IP asset in line with footnotes 16 and 19 on page 42 of the Action 5 report	<p>a. Does your regime limit benefits based on the location of the R&D activities in the case of related-party outsourcing and acquisitions?</p>	Yes/No	No
	<p>b. If yes, please explain how your regime limits benefits based on the location of R&D activities.</p>		
13. Rebuttable presumption	<p>a. Does your regime treat the nexus ratio as a rebuttable</p>	Yes/No	No

Country		Country name
	presumption?	
	b. If yes, please answer to the following questions (i) through (iii)	(i) Please describe how departures from the application of the nexus ratio will be limited to the exceptional circumstances described in paragraph 48 of the Action 5 Report.
		(ii) Please provide examples of situations where your jurisdiction expects taxpayers to rebut the presumption.
		(iii) Please describe the procedures you have implemented to ensure annual reporting to the FHTP and spontaneous exchange of information.

This is an unofficial translation of the Polish IP BOX provisions as included in the Corporate Income Tax Act (CITA) of 15 July 1992 (Pol. *Ustawa z dnia 15 lutego 1992 r. o podatku dochodowym od osób prawnych*), Journal of Laws of 1992, No. 21, item 86 – articles 24d and 24e. The translation has been made by the Income Tax Department at the Ministry of Finance of Poland, including tax officials responsible for drafting the IP BOX provisions and their interpretation.

Article 24d . 1 Tax on qualified income earned from qualified intellectual property rights shall be 5% of the tax base.

2. Qualified intellectual property rights shall mean:

- 1) right to invention (patent)
- 2) protection right for a utility model
- 3) rights in registration of an industrial design
- 4) rights in registration of the integrated circuit topography
- 5) supplementary protection certificate for a patent for a medicinal product or plant protection product
- 6) right in registration of the medicinal and veterinary product admitted to trading
- 7) the exclusive right, set out in the Act of 26 June 2003 on legal protection of plant varieties
- 8) copyright to a computer program

- subject to legal protection under separate regulations or ratified international agreements to which the Republic of Poland is a party, and other international agreements to which the European Union is a party, whose subject of protection was created, developed or improved by the taxpayer as a part of his research and development activity. **(This paragraph refers to all intellectual property rights as listed above – an exhaustive list – from point 1 to 8).**

3. The tax base shall be the sum of qualified income earned in a tax year from qualified intellectual property rights.

4. The amount of the qualified income earned from qualified intellectual property rights is a value calculated as the product of income earned from qualified intellectual property rights and the ratio calculated according to the formula:

$$\frac{(a + b) * 1,3}{a + b + c + d}$$

where each letter means expenses actually incurred by the taxpayer on:

a - research and development activities undertaken by the taxpayer and related to qualified intellectual property right,

b - the outsourcing of R&D activity related to qualified intellectual property right other than those listed in the letter d, from an unrelated party within the meaning of Article 11a, paragraph 1 subparagraph 3,

c - the outsourcing of R&D activity related to qualified intellectual property right other than those listed in the letter d, from a related party within the meaning of Article 11a, paragraph 1 subparagraph 4,

d - the acquisition of qualified intellectual property right by the taxpayer.

5. The costs set out in paragraph 4 do not include the costs which are not directly related to a qualified intellectual property right, in particular interests, financial charges, costs related to the property.

6. If the value of the ratio referred to in paragraph 4 is greater than 1, it is assumed to be 1.

7. Income (loss) earned from qualified intellectual property rights is the income earned by the taxpayer in the tax year:

1) from royalties or other fees related to qualified intellectual property rights,

2) from the sale of qualified intellectual property rights;

3) from the qualified intellectual property right included in the selling price of the product or service;

4) from compensation for infringement of rights resulting from a qualified intellectual property right obtained in litigation, including court proceedings or arbitration.

8. The provisions of article 11c shall apply accordingly to determine the income referred to in paragraph 7, subparagraphs 3.

9. If the taxpayer fails to determine the income allocated to each qualified intellectual property rights, the taxpayer may calculate the income earned from qualified intellectual property right in accordance with paragraph 4-6 for the same type of product or service or group of products or services, in which qualified intellectual property right has been used.

10. Income related to qualified intellectual property right or the same type of product or service in which qualified intellectual property right has been used shall be reduced – in 5 subsequent tax years - by the amount of the loss from qualified intellectual property right incurred in the tax year.

11. The taxpayers applying the taxation in accordance with the paragraph 1 are obliged to indicate income (loss) referred to in paragraph 7, in the tax return for the tax year in which the income (loss) is incurred.

12. The provisions of paragraph 1-11 shall also apply to the expectancy right of receiving the qualified intellectual property right in connection with the submission of an application to obtain a relevant protection right to the competent authority, from the date of submission of this application.

13. In case of withdrawal of the application, refusal to grant a protection right of protection or rejection of the application, the taxpayer is obliged to tax the qualified incomes referred to in paragraph 4 earned in the period from the date of submission of the application referred to in paragraph 12 to the date of withdrawal of the application, refusal to grant a protection right or rejection of the application, in accordance with the rules set out in article 19. In this case, the tax paid in accordance with paragraph 1 is deducted from the tax calculated from the total amount of income.

14. The provisions of paragraph 1-13 shall apply accordingly to the taxpayer's income from licenses to use the qualified intellectual property right under an agreement in which the taxpayer's exclusive right to use it is reserved, provided that the taxpayer has previously carried out research and development activity which resulted in a qualified intellectual property right for which this license has been granted.

Article 24e 1. The taxpayers applying the taxation in accordance with the paragraph 1 are obliged:

- 1) identify each qualified intellectual property right in the kept accounting records;
- 2) keep accounting records in a way that ensures determination of revenues, tax deductible costs and income (loss) attributable to each qualified intellectual property right;
- 3) to identify the costs referred to in paragraph 4, for each qualified intellectual property right, in a way that ensures the determination of qualified income;
- 4) make entries in the kept accounting records in a manner ensuring the determination of the total income from these qualified intellectual property rights - in case when the taxpayer uses more than one qualified intellectual property right, and it is impossible to meet conditions referred to in points 2 and 3 in the kept accounting records;
- 5) make entries in the kept accounting records in a way that ensures determination of the income from qualified intellectual property rights for a product or service, or for those products or services, if the taxpayer uses one or more of the qualified intellectual property rights in the product or service or in products or services, and it is not possible to meet the conditions referred to in points 2-4 in the kept accounting records.

2. If it is not possible to determine the income (loss) from qualified intellectual property rights on the basis of the accounting records, the taxpayer is obliged to pay the tax in accordance with article 19 (on general rules).

II / FINAL ASSESSMENT

The following assessment was agreed by the Code of Conduct Group on 11 April 2019:

	1a	1b	2a	2b	3	4	5	OA
PL – Preferential taxation of income derived from intellectual property rights (IP Box) (PL012)	X	?	X	?	X	X	X	X

In accordance with the 24 November 2016 report of the Code of Conduct Group to the Council, the following assessment has been prepared with regard to paragraphs 1 to 5 of the Code of Conduct. This draft assessment is based on the responses to the OECD FHTP questionnaire (hereafter referred to as the "agreed description"¹) provided by Poland to the Commission services on 8 February 2019. This measure was assessed against all Code criteria and on the basis of the modified nexus approach.

Explanation

Significantly lower level of taxation:

“Within the scope specified in paragraph A, tax measures which provide for a significantly lower effective level of taxation, including zero taxation, than those levels which generally apply in the Member State in question are to be regarded as potentially harmful and therefore covered by this code”

The *Preferential taxation of income derived from intellectual property rights* (hereafter called the “IP Regime”) applies for the calculation of Corporate Income Tax in Poland from 1 January 2019 onwards.

An effective corporation tax rate of **5%** applies, compared to the current Polish headline corporate tax rate of **19%**.

This rate is significantly lower than the rate generally applying. **It is therefore potentially harmful within the meaning of paragraph A of the Code.**

Criterion 1:

¹ For this particular exercise, the Member State's reply to the OECD questionnaire for FHTP.

“whether advantages are accorded only to non-residents or in respect of transactions carried out with non-residents”

Criterion 1 contains two elements. The first element is whether the measure is exclusively available to non-residents or transactions with non-residents (criterion 1a). The second element is whether it is only or mainly used by non-residents or for transactions with non-residents (criterion 1b).

1a) Criterion 1a concerns the *de jure* application of the measure.

Qualifying taxpayers are those who create, develop or improve the subject of protection of qualified intellectual property rights as a part of their R&D activity, whose income from the qualified IP rights is subject to taxation in Poland. There appear to be no provisions in the legislation restricting the benefits to transactions with non-residents.

1b) Criterion 1b is used to complement the assessment under criterion 1a which only looks at the literal interpretation of the measure. It takes account of the *de facto* effect of the measure. Where the majority of taxpayers (or counterparties to transactions) benefitting from the measure are in fact non-residents the measure will fall foul of criterion 1b.

In light of the recent introduction of the IP regime, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive effects of the new regime. In addition the agreed description in the format used lacks this data.

This is a horizontal issue for almost all IP regime assessments. To the extent that our draft assessment is based on currently available information on statistics, we suggest that the group reserves the possibility of reaching a potentially different outcome of a future assessment based on more complete information.

Criterion 2:

“whether advantages are ring-fenced from the domestic market, so they do not affect the national tax base”

As regards criterion 2, the division between criteria 2a and 2b is done in the same way as in the case of criterion 1 (i.e. *de jure* interpretation and *de facto* analysis). In general, a measure is caught by criterion 2 if the advantages are ring-fenced from the domestic market so that they do not affect the national tax base. In most cases, the evaluation against criterion 2 follows closely that of criterion 1.

2a) What has been written under criterion 1a applies analogously to criterion 2a.

There are no rules preventing domestic taxpayers from benefiting from the IP regime or to exclude domestic transactions.

2b) On the basis of the explanations provided above and the marking under criterion 1b, the evaluation of criterion 2b follows the same reasoning.

In light of the recent introduction of the IP regime, it is unlikely that statistical or impact data is either available at this stage, or representative enough to reflect the comprehensive effects of the new regime. In addition, the agreed description in the format used lacks this data.

This is a horizontal issue for almost all IP regime assessments. To the extent that our draft assessment is based on currently available information on statistics, we suggest that the group reserves the possibility of reaching a potentially different outcome of a future assessment based on more complete information.

Criterion 3:

“whether advantages are granted even without any real economic activity and substantial economic presence within the Member State offering such tax advantages”

In November 2014 the Group agreed, in co-ordination with developments at the OECD, on the modified nexus approach as the appropriate method to ensure that patent boxes require sufficient substance. Therefore, under this agreed approach, criterion 3 for the Code is to be interpreted in line with the modified nexus approach. The key elements of the modified nexus approach are: Scope (qualifying IP assets), Nexus ratio, Tracking and tracing, Rebuttable presumption and Treatment of losses.

1. Scope:

Qualifying IP assets: Income benefiting from an IP regime has to come from a qualifying asset, comprised in one of the three categories 1) patents and functionally equivalent assets including utility models, protection granted to plants and genetic material, orphan drug designations and extensions of patent protection; 2) copyrighted software, and 3) assets that share the features of patents and are substantially similar to the two previous categories and are certified as such by a competent government agency in the State².

² Category limited to companies which are not part of a group with more than €50m turnover and gross revenues of €7.5m from all IP assets.

According to Article 24d of the 1992 Act on Corporate Income Tax, the Polish IP regime applies benefits to:

- Patents
- Protection right to a utility model
- Rights in registration of Industrial design
- Rights in registration of the integrated circuit topography
- Supplementary protection certificate for patent for a medicinal product or plant protection product
- Right in registration of the medicinal and veterinary product admitted to trading
- The exclusive right set out in the Act on legal protection of plant varieties
- Copyright to a computer program

In addition to the above categories of qualifying IP rights, the PL IP regime also allows benefits for the **expectancy right** of receiving a qualified IP right. In the case of withdrawal, refusal, or rejection of the application for the IP right, the taxpayer must pay tax on the qualified income at the full statutory rate of 19%. Tax already paid at the lower rate is deducted from the total amount due.

According to the English translation of the legislation provided to the Commission services, the above list of qualifying IP assets is exhaustive. The legislation also specifies that all of the categories of qualifying IP rights must be subject to legal protection. Furthermore, the Polish legislation specifies that the subject of legal protection must be created, developed or improved by the taxpayer as a part of its research and development activity.

The PL IP regime does not cover the third category of IP assets for small and medium size enterprises³. Therefore, there is no annual reporting obligation to the OECD FHTP or spontaneous exchange of information required.

According to the agreed description, the income that qualifies for the regime is income earned by the taxpayer in the tax year:

- From royalties or other fees relating to qualified intellectual property rights.

³ Given that such inventions are substantially similar to the IP assets in the first two categories, they should be certified in a transparent certification process by a competent government agency that is independent from the tax administration.

- From the sale of qualified intellectual property rights.
- From the qualified intellectual property right included in the selling price of the product or service.
- From compensation for infringement of rights obtained in litigation.

In summary, the scope of the Polish IP regime is in line with the Nexus approach.

2. Nexus ratio:

The tax advantage granted under the PL IP regime is a reduced tax rate of 5%.

This reduced rate applies on the relevant qualifying net IP income. The portion of income qualified for the reduced rate is calculated under the modified nexus formula.

The amount of the qualified income earned from qualified intellectual property rights that benefits for the reduced 5% tax rate is calculated as the product of income earned from qualified intellectual property rights and the ratio calculated according to the formula:

$$((a+b)*1,3)/(a+b+c+d)$$

In this formula each letter means expenses actually incurred by the taxpayer on:

a - research and development activities undertaken by the taxpayer and related to qualified intellectual property right,

b- the acquisition of the results of research and development works related to qualified intellectual property right other than those listed in the letter d, from an unrelated party

c- the acquisition of the results of research and development works related to qualified intellectual property right other than those listed in the letter d, from a related party.

d – the acquisition of qualified intellectual property right by the taxpayer.

This formula accurately reflects the “nexus ratio” as depicted in the OECD’s Report on BEPS Action 5:

[QE (+30% uplift) / OE x OI]:

- QE being qualifying expenditure excluding outsourcing to related parties and acquisition costs;
 - OE being overall expenditure, including outsourcing to related parties and acquisition costs;
 - OI being overall income calculated as a net income.
- Embedded royalties: *The separation of embedded royalties from other income must use a “consistent and coherent method” according to the nexus approach. If embedded royalties are allowed into patent boxes, there should be a clear method for identifying them. Transfer pricing principles are identified as one possibility.*

According to the agreed description, the eligible income from embedded royalties is calculated by applying transfer pricing principles. The new Polish transfer pricing principles are contained in Article 11c of the CITA.

In summary, the nexus ratio aspects of the Polish IP regime appears to be in line with the nexus approach.

3. Tracking and tracing:

MS must require companies to track expenditure, IP assets and income. When such tracking would be unrealistic and require arbitrary judgements, MS may allow the application of the nexus approach so that the nexus may be between expenditure, products arising from IP assets and income (product-based approach). It requires tracking of all QE and OE at the level of the product.

The PL IP regime sets specific provisions regarding the tracking and tracing requirements under the IP regime. The entity is required to maintain accounting records needed to determine income and expenses related to the IP assets involved. This means that tracking and tracing is ensured. The product-based approach is also allowed.

4. Rebuttable presumption⁴:

⁴ Jurisdictions could treat the nexus ratio as a rebuttable presumption but would need to limit to exceptional situations where the ratio could be rebutted to those that meet at minimum the following requirements: the taxpayer should first use the nexus ratio to establish the presumed amount of income that could qualify for benefits; the nexus ratio (excluding the up-lift) should equal or exceed 25%; the taxpayer should demonstrate that

Under the PL IP regime, the nexus ratio is not treated as a rebuttable presumption.

5. Treatment of losses⁵:

The treatment of losses associated with the IP income corresponds to the *separate loss method*. This means that IP losses can only be set off against the IP income. IP losses cannot be used against ordinary income, even if there is no IP income against which to use the losses. IP losses may be carried forward to be used against future IP income (in 5 subsequent tax years).

Criterion 4:

“whether the rules for profit determination in respect of activities within a multinational group of companies departs from internationally accepted principles, notably the rules agreed upon within the OECD”

- General transfer pricing rules:

Poland applies the arm's length principle and the IP regime legislation makes reference to Article 11c CITA which contains the new Polish Transfer Pricing provisions (effective from 1 January 2019).

The arm's length principle is relevant to the following features of a patent box: the reduction of the tax base by a fixed percentage, if any; the calculation of royalty profits; the application of safe harbour rules; the asymmetrical treatment of losses (if any).

- Reduction of the tax base by a fixed percentage: *in principle, reducing a company's arm's length profits by a fixed amount means that the final result does not reflect the arm's length principle. This is a question about the circumstances in which fixed reductions of the tax base are acceptable and is therefore part of the overall assessment that the Group need to make.*

The tax benefit under the Polish IP regime is granted through a reduced tax rate and not a reduction in the tax base. Therefore, the amount of the basis of income is not modified in the IP regime in a way that would not reflect the arm's length principle.

because of exceptional circumstances, the application of the nexus ratio would result in an outcome inconsistent with the nexus approach (burden of proof on the taxpayer).

⁵ Note 14 to Action 5 Report: Jurisdictions should also use any tax losses associated with the IP income in a manner that is consistent with domestic legislation and that does not allow the diversion of those losses against income that is taxed at the ordinary rate.

- Calculation of royalty profit (embedded royalties): *where transfer pricing rules exist, the profits that go into a patent box will reflect the arm's length principle because they are just a part of the company's total profit. In principle this applies both to royalties and embedded royalties. If the IP regime covers also the latter category, its identification within the sale price of a product should rely on transfer pricing principles.*

What has been written above under criterion 3 on the same topic applies analogously to criterion 4.

- Safe harbour rules: *adoption of safe harbours is not in accordance with internationally agreed principles; safe harbours are not recommended in the Transfer Pricing Guidelines.⁶*

The Polish IP Regime does not seem to provide for such safe harbour rules.

- Asymmetrical treatment of losses: *where the profits from particular IP assets are taxed at a lower rate in a patent box then the losses should be treated in the same way and not deducted outside the box at a higher rate.*

What has been written under criterion 3 above on losses applies analogously to criterion 4.

Criterion 5:

“whether the tax measures lack transparency, including where legal provisions are relaxed at administrative level in a non-transparent way”

All preconditions necessary for the granting of a tax benefit should be clearly laid down in publicly available laws, decrees, regulations *etc.* before a measure can be considered transparent.

The nexus approach contains commitments to additional transparency in three areas. These concern the third category of qualifying assets, new entrants to existing IP regimes after 6 February 2015 and the rebuttable presumption rule.

Third category of qualifying assets

Not applicable, as third category of IP assets is not covered by the Polish IP regime.

New entrants

⁶ *Transfer Pricing Guidelines*, p167.

Not applicable, as the regime came into force on 1 January 2019.

Rebuttable presumption rule

Not applicable, as nexus ratio is not treated as a rebuttable presumption.

Overall assessment:

In light of the assessment made under all Code criteria, the Polish IP regime is considered as **not harmful** from a Code of Conduct point of view.

Overall, the PL IP regime is in line with the modified nexus approach. Similar to other recently introduced or amended measures, question marks remain in the grids in relation to criteria 1b and 2b.

In summary, the Group's overall assessment is that this measure is **not harmful**.
