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Spis treści

Wstęp ... 9

Tomasz Banasik, Katarzyna Brzozowska-Rup: Metodologiczne aspekty oceny oddziaływania OFE na rozwój gospodarczy w Polsce / Methodological aspects of assessment of Pension Funds influence on the economic development of Poland ... 11

Krzysztof Berbeka: Polityka klimatyczna w warunkach kryzysu finansowego / The climate policy in the conditions of financial crisis ... 27

Marcin Brycz: ATP-pension fund's investments and consumption in Sweden 1961–1994. Past example, but problem still not resolved / Inwestycje funduszy emerytalnych ATP a konsumpcja w Szwecji (1961–1994). Miniony przypadek, lecz problem wciąż aktualny ... 40

Agnieszka Deresz, Marian Podstawka: Zróżnicowanie obciążeń fiskalnych dochodów osób fizycznych w Polsce / Differentiation of tax burden on individual taxpayers in Poland... 52

Marek Dylewski: Instrumenty stabilizowania długoterminowej równowagi finansowej JST / Instruments for stabilizing the long-term financial balance of LGU ... 64

Beata Zofia Filipiak: Dylematy pomiaru potencjału finansowego jednostek samorządu terytorialnego – dobór czynników i ich pomiar / Dilemmas of measuring the potential financial – selection of factors and their measurement ... 75

Mateusz Folwarski: Czynniki wpływające na rozwój sieci bankomatów w krajach Europy Środkowej / Factors affecting the development of the ATM network in Central Europe ... 89

Maria Magdalena Golec: Zmiany regulacyjne w sektorze Spółdzielczych Kas Oszczędnościowo-Kredytowych i ich ocena / Regulatory changes in the cooperative savings and credit unions and their evaluation ... 99

Marcin Gospodarowicz: Efektywność wspierania rozwoju przedsiębiorczości ze środków UE w gminach na obszarach wiejskich w Polsce w latach 2007–2013 / Efficiency of entrepreneurship support from EU funds in rural communes in Poland (2007–2013)... 110

Gabriela Gurgul: Kierunki kreacji marki i zmiany w zarządzaniu produktami bankowymi wobec tła gospodarczo-politycznego oraz oczekiwań klientów detalicznych / Directions of brand creation and changes in managing banking products (against an economic and political background and expectations of retail customers) ... 122

Mariusz Hamulczuk, Marcin Idzik: Zgodność i predyktywność testów koniunktury bankowej z koniunkturą ogólnogospodarczą / Compliance and forecasting of the surveys of the banking situation with the overall economic situation.......... 134
Aneta Kargol-Wasiluk, Adam Wyszkowski: Preferencje podatkowe wspierające działalność B + R w ramach podatków dochodowych w Polsce i w Wielkiej Brytanii / Tax incentives supporting R&D activities in Poland and in the United Kingdom.......... 145
Krzysztof Kil, Radosław Ślusarczyk: Determinanty marży odsetkowej banków w Polsce w okresie pokryzysowym / Determinants of banks' net interest margins in Poland.......... 162
Julitta Koćwin: Sytuacja konsumenta na rynku szarej bankowości / The consumer situation on the informal banking market.......... 175
Magdalena Kogut-Jaworska: Pomoc publiczna i jej szczególne znaczenie w systemie wsparcia publicznego w Polsce / Public aid and its particular role in the system of state aid in Poland.......... 187
Agnieszka Kristof: Skarb Państwa w roli właściciela przedsiębiorstw / State treasury as the owner of companies.......... 198
Justyna Kujawska: Wpływ struktury finansowania na wyniki funkcjonowania systemów opieki zdrowotnej w krajach Unii Europejskiej / The impact of financing structure on the healthcare systems outcomes in the European Union countries.......... 207
Elwira Leśna-Wierszołowicz: IKE i IKZE jako dobrowolne formy gromadzenia oszczędności emerytalnych / Individual retirement accounts and individual retirement security accounts as voluntary forms of pension savings.......... 219
Marta Maier: System zabezpieczenia emerytalnego a starzenie się społeczeństwa w Polsce / Pension security system and aging society in Poland 230
Dariusz Malinowski, Marcin Krawczyk: Oddziaływanie ekspansji fiskalnej wspomaganej przez monetarną na produkcję – ujęcie teoretyczne i na przykładzie wybranych gospodarek / The impact of money accommodated fiscal expansion on production – theory and experience of selected countries.......... 240
Paweł Marszałek: Disintermediation of banks – causes and consequences / Dezintermediacja banków – przyczyny i konsekwencje.......... 256
Małgorzata Mazurek-Chwiejczak: Wydajny fiskalnie system podatkowy – w poszukiwaniu modelowych rozwiązań / The fiscally efficient tax system – in search of model solutions.......... 268
Dominika Mierzwa, Ewa Blaszke: Źródła finansowania zewnętrznego jednostek samorządu terytorialnego na przykładzie miasta Wrocławia / The sources of external funding of local government entities on the example of the city of Wrocław.......... 280

Elżbieta Izabela Misiewicz: Zmiany przepisów o jednym procencie należnego podatku dochodowego od osób fizycznych a zachowanie podatników / Changes in one percent of the tax regulations and tax-payers behaviour... 291
Monika Pasternak-Malicka: Funkcja fiskalna podatku od towarów i usług a znieczulenie podatkowe / Tax illusion and its impact on the fiscal function of the taxation of goods and services 301
Jacek Pera: Ocena wpływu zadłużenia zagranicznego na ryzyko kredytowe Polski w modelu roszczeń warunkowych / Impact of foreign debt on Polish credit risk in the model of contingent claims approach 314
Elwira Pindyk: Wpływ zmiany systemu opodatkowania nieruchomości od osób fizycznych na budżet gminy / Impact of changes in taxation of real estates of individuals on district's budget.. 329
Piotr Podsiadło: Pomoc publiczna w formie gwarancji – analiza jakościowa i ilościowa z perspektywy polityki fiskalnej / State aid in the form of guarantees – qualitative and quantitative analysis from the perspective of fiscal policy.. 347
Magdalena Rękas: Ulgi na dzieci jako instrument polityki rodzinnej a niska dzietność w Polsce / Relief for children as an instrument of family policy and low fertility in Poland 360
Katarzyna Rola: Wpływ podatku akcyzowego na konsumpcję alkoholi / Impact of excise tax on alcohol products consumption 374
Alicja Sekuła, Roman Fandrejewski: Naruszenie dyscypliny finansów publicznych w zakresie wykorzystania subwencji ogólnej / The violation of public finance discipline with respect to the use of general grant 385
Tomasz Sobczak: Rola krajowych oszczędności w poglądach wybranych ekonomistów Polski międzywojennej / The role of domestic savings in views of chosen economists of interwar-Poland....................................... 398
Błażej Socha: Działalność innowacyjna a wyniki finansowe przedsiębiorstw / Innovation and financial performance 411
Małgorzata Sosińska-Wit, Karolina Gałązka: Aktywność inwestycyjna mikro-, małych i średnich przedsiębiorstw w województwie lubelskim / Investment activity of micro-, small and medium-sized enterprises in the region of Lublin 420
Michał Sosnowski: Transfer pricing issues in taxation of related entities / Problematyka cen transferowych w opodatkowaniu podmiotów powiązanych.. 431
Wacława Starzyńska: Metody statystyczne w analizie rynku zamówień publicznych / Statistical methods in analysis of public procurements 448
Małgorzata Szczepaniak: Nierównowaga finansów publicznych w Polsce na tle krajów Europy Środkowo-Wschodniej i UE 28 / Conditions of public finances' imbalance in Poland compared to the countries of Central and Eastern Europe and all European countries (EU 28) 457

Joanna Śmiechowicz, Paulina Kozak: Diagnoza skutków polityki podatkowej gmin w Polsce w latach 2003–2015 / The issue of maximization of own revenue potential and the tax policy of municipalities in Poland in the years 2003–2015 468
Tomasz Śmietanka: Gospodarka finansowa gmin Grójec, Kozienice, Szydłowiec w latach 2003–2016 jako czynnik rozwoju lokalnego / Financial economy of the communes Kozienice, Grójec, Szydłowiec in the years 2003–2016 as a factor of sustainability development at the local level 479
Anna Świrska: Skuteczność mechanizmu subwencjonowania w wyrównywaniu sytuacji dochodowej gmin / Effectiveness of the subsidizing mechanism in equalizing the income situation of municipalities........ 497
Małgorzata Twarowska: Wpływ dodatkowego opodatkowania sektora finansowego na napływ zagranicznych inwestycji bezpośrednich w krajach UE / Impact of additional financial sector taxation on the Foreign Direct Investment inflow in the EU countries 509
Maciej Woźniak, Robert Lisowski: Ocena związku preferencji podatkowych z poziomem inwestycji przedsiębiorstw w Polsce / Evaluation of relationship between fiscal instruments and investments of companies in Poland 520
Mariusz Zieliński: Klienci i pracownicy jako beneficjenci działań CSR w sektorze bankowym w Polsce / Customers and employees as recipients of CSR activities in the banking sector in Poland 533
Arkadiusz Żabiński, Elżbieta Pohulak-Żołędowska: Fiskalne uwarunkowania budowy systemu podatkowego w wybranych krajach / Fiscal stimulants of creation of tax system in chosen countries 543

Wstęp

Publikacja *Finanse publiczne* została wydana w ramach Prac Naukowych Uniwersytetu Ekonomicznego we Wrocławiu. Poszczególne jej części stanowią dorobek pracowników naukowych najbardziej liczących się w Polsce ośrodków naukowych. Przedstawione opracowania odnoszą się do całego spektrum problemów naukowo-badawczych związanych z finansami publicznymi i polityką fiskalną. Poszczególni autorzy prezentują wyniki swoich badań teoretycznych i empirycznych w zakresie zarządzania dochodami i wydatkami budżetu centralnego oraz budżetów jednostek samorządu terytorialnego, w kontekście zarówno reformy finansów publicznych, reformy systemu emerytalnego, pomocy publicznej, jak i teoretycznych podstaw realizacji wyznaczonych celów przez narzędzia polityki fiskalnej.

Niniejsza publikacja jest adresowana do środowisk naukowych i studentów wyższych uczelni oraz osób, które w praktyce gospodarczej mają styczność ze stroną dochodową lub wydatkową polityki fiskalnej.

Poszczególne fragmenty książki były recenzowane przez profesorów uniwersytetów, w większości kierowników katedr finansów, katedr ekonomii oraz polityki ekonomicznej, którym chciałbym podziękować za rzetelne recenzje. Składam również wyrazy uznania pracownikom Katedry Ekonomii i Polityki Ekonomicznej Uniwersytetu Ekonomicznego we Wrocławiu oraz pracownikom Wydawnictwa za wiele wysiłku i zaangażowanie, dzięki któremu powstała ta publikacja.

Mam głębokie przekonanie, że książka *Finanse publiczne*, którą oddajemy w Państwa ręce, będzie inspiracją do dalszych badań i dociekań naukowych oraz do powstania równie inspirujących opracowań w przyszłości.

Jerzy Sokołowski

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TRANSFER PRICING ISSUES IN TAXATION OF RELATED ENTITIES

PROBLEMATYKA CEN TRANSFEROWYCH W OPODATKOWANIU PODMIOTÓW POWIĄZANYCH

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Summary: The paper discusses the issue of transfer pricing associated with the taxation of transactions between entities affiliated personally or in capital. A phenomenon of described herein takes place in situations where these links result in the understatement of income and failure to show the income by the related entities. The main reasons for this phenomenon and the methods of limiting thereof are presented here. In addition, the issue of pricing agreements (APA) is touched. In conclusion, the tax regulations discussed are intended to reduce the incidence of shifting the profits between affiliated companies. In the current economic environment, it is not an easy task, since the benefits accruing from this practice are significant. Therefore, the temptation to use the mechanism of transfer pricing is high. Certainly, reducing the tax burden and simplifying the tax system should promote the elimination of such practices from the polish economic life.

Keywords: transfer pricing, advance pricing agreement, income tax.

Streszczenie: Artykuł omawia problem *transfer pricing* wiążący się z opodatkowaniem transakcji pomiędzy podmiotami powiązanymi kapitałowo bądź osobowo. Opisane zjawisko dotyczy sytuacji zaniżenia uzyskiwanych dochodów lub niewykazywania tych dochodów przez powiązane strony. Wykorzystując analizę literatury i badania statystyczne, zaprezentowano tu główne przyczyny tego zjawiska i metody jego ograniczania. Ponadto omówiona została kwestia uprzednich porozumień cenowych (APA). Konkludując, należy stwierdzić, że omówione regulacje prawnopodatkowe mają na celu ograniczanie zjawiska transferu zysków pomiędzy powiązanymi przedsiębiorstwami. W obecnych realiach gospodarczych nie jest to zadanie łatwe, ponieważ wciąż odnoszone korzyści z tego procederu są znaczne, a więc i pokusa wykorzystywania mechanizmu cen transferowych jest duża. Z pewnością obniżenie ciężarów podatkowych i uproszczenie systemu podatkowego powinno sprzyjać eliminacji tego rodzaju praktyk z polskiego życia gospodarczego.

Słowa kluczowe: ceny transferowe, uprzednie porozumienia cenowe, podatek dochodowy.

1. Introduction

The globalization of business processes, increasing degree of freedom in terms of trade and progressive economic integration between individual countries are factors favourable to formation of various forms of business cooperation which lose their national character, becoming international economic associations of growing economic and technical potential. Changes in economic law in many countries and a favourable political climate also create an incentive for such transnational forms of economic activity. The primary purpose of these transnational economic organisms – like most forms of economic activities – is to achieve maximum benefits possible through the full use of opportunities offered by the process of globalization of socio-economic development. In terms of business activities, these companies also seek to optimize the tax burden by manipulating prices in trade between their constituent companies whose headquarters are located in countries with different legal and tax systems. From the point of view of those economic entities, the possibility to accumulate all the profits in the company the registered office of which is located in a country with the most liberal tax system in order to make public tributes as least severe as possible would be the most advantageous one. However, it should be noted that the optimization of tax burden is also carried out between entities affiliated in capital and those domiciled in only one country, so the issue discussed there has both national and international dimension.[1]

The aim of the paper is to analyse the problem of transfer pricing and to evaluate the functioning of the existing Polish legal regulations in this area with regard to the taxation of related entities' incomes, both at the domestic and international level. The issue of transfer pricing is no longer a new phenomenon in Poland, but it is still a complicated and difficult phenomenon, despite the fact that it becomes better regulated in the tax law. Illegal abuse of transfer pricing is a common phenomenon among companies controlled by their foreign parent companies. A particular growth of interest in the transfer prices is seen in recent years, as a result of the initiatives implemented at both an international level (BEPS – Base Erosion and Profit Shifting), and local levels. Without a doubt, in recent years, multinational corporations are paying more attention to the management of transfer pricing in emerging markets.

2. The essence of transfer pricing

All actions that boil down to the manipulation of prices in transactions made between related entities are internationally called "transfer pricing". According to the Glossary of International Tax Terms [*Międzynarodowy słownik...* 1997, p. 500], transfer prices are the prices of goods, services, intangibles and fees applied between related companies are different from the prices negotiated on the free market and included

[1] According to estimates, 40–60% of world trade take place within multinational companies.

in terms and conditions compared by unrelated partners [Sojak, Baćkowski 2003]. Thus, the concept of transfer prices means cases where, following the links between economic activities, these entities arrange their relationships in a way that differs from the conditions that would be agreed by unrelated entities in similar cases. Tax consequence of such relations is the underreporting of income and keeping these revenues off the balance sheet of a given entity, since the income generated by one entity is proven as the income of another entity often having its registered office in the so-called tax haven, i.e., in a country or territory which – generally speaking – allows for avoiding taxation of the income.

The most popular way is to undercut export prices when the goods are sent to a foreign company belonging to the same group. Margins for affiliates tend to be significantly lowered. It happens that sales prices to related entities are below the actual cost, while in the case of others – on the same foreign markets – the margins are tens and even hundreds of times higher. It is natural that each foreign investor undertaking a business activity wants to gain as much as possible. Therefore, it is often better for him to show the profit not in Poland, where his/her company or subsidiary has its manufacturing facility, but where it has its registered office – the parent company.

Tax authorities confirm that the phenomenon of transfer pricing occurs on an increasing scale and takes more and more complex forms. It has an unfavourable effect not only on the state budget which collects lower tax revenue, but also on minority shareholders, since their shares are less profitable. It goes without saying that any corporation which has branches in many countries and pays different taxes in each of them is tempted to show the profit where the tax burden is the lowest. In turn, price manipulations and cost-shifting between related national entities usually concern small amounts – from a few to ten per cent of what takes place in case of international companies. Related Polish companies do not usually bear licensing or management costs. They are trying to "help" related companies in other ways, e.g. by selling parts of fixed assets at depressed prices and giving them interest-free loans. Equally often, transfer prices are manipulated by companies with different legal forms and taxation principles.

According to the research by Ernst&Young, 66% of companies identified "risk management" as their highest priority for transfer pricing in this latest survey, a 32% increase over surveys conducted in 2007 and 2010. One can see a sharp increase in tax controversy around the world in general, and regarding transfer pricing in particular. For instance, 77% of companies surveyed in 2011–12 Tax Risk and Controversy Survey said they anticipated managing tax risk and controversy would become more important in the next two years [Ernst&Young 2013a]. Correspondingly, the percentage of companies identifying cash tax or effective tax rate optimization as their highest transfer pricing priority fell by nearly one-third – to 17% – from just three years ago. 47% of parent companies reported that they have experienced double taxation as a result of a transfer pricing adjustment. To mitigate double taxation, 28% of companies said they had referred a transfer pricing matter to competent authority in the past three years, a 55% increase over 2010.

In addition, according to the cited studies of Ernst&Young, in the past three years were imposed tax penalties on a quarter of the respondents parent companies (shareholders), while in the study for 2010, the figure was 19% (2007 – 15%). In turn, 28% respondents (two times more than in the previous survey) declared that in the past three years turned for help to the government of their country in order to alleviate the dispute with the tax authorities of another country. Companies are also reporting a 15% increase in litigation, with just 4% in 2007. Companies claim that they are taking increased efforts in order to comply with applicable regulations. 70% of respondents stated that they fully apply to the applicable requirements and regulations on transfer pricing. However, only less than 20% one monitors the financial results for compliance with its own policies in the area of transfer pricing, date or month, which is the optimal solution. Only a very small minority of parent companies (4%) left the preparation of transfer pricing documentation until an audit request arose. Some companies have a system solutions (e.g. computer programs) that facilitate and automate activities related to transfer pricing [Ernst&Young 2013b].

3. The methods of estimating the income in situation of the use of transfer pricing

Regulations to combat income shifting within the framework of the Polish laws on income tax were already set out in the Act on income tax of 1936 which was in force in the interwar period. In the post-war period, they were introduced into the Act on income tax, which entered into force on 1 January 1973. The Ministry of Finance, aware of the importance of this problem, have constantly intended to improve the existing regulations in such a way as to create legal instruments that would allow for more effective prosecution and prevention of the occurrence of this phenomenon, as well as to introduce new elements resulting from experiences collected both in Poland and in other countries into the Polish tax system. In 1992, the regulations determining when transactions between particular entities are considered to be transactions between related entities have been introduced into the Acts on income taxes: The Legal Persons' Income Tax Act (CIT) and The Natural Persons' Income Tax Act (PIT).[2]

According to the CIT and PIT acts, if: 1) an income tax payer having its registered office (management) or residing on the territory of the Republic of Poland, hereinafter referred to as "domestic entity" participates directly or indirectly in managing the company having its registered office abroad or has shares in the share capital of

[2] See: art. 11 of the Act on legal persons' income tax [Ustawa z 15 lipca 1992] and art. 25 of the Act on natural persons' income tax [Ustawa z 26 lipca 1991].

such a company, or 2) natural or legal person residing or having its registered office (management) abroad, hereinafter referred to as “foreign entity” participates directly or indirectly in managing a domestic entity or in its control or has shares in the capital of such a domestic entity, or 3) the same natural or legal persons at the same time directly or indirectly participate in managing a domestic and a foreign entity or their control or have shares in the capital of these entities – and if these links result in establishing or imposing conditions different from the conditions that could be established by independent entities and, as a result, such an entity does not show the income or shows income lower than could be expected in a situation where the said links would not exist – income of a given entity and the tax due shall be calculated without taking into account the conditions resulting from these links.

On the other hand, with effect from 2001, following the amendments of the relevant Acts on income taxes, the legislation on the use of transfer pricing has been clarified. The rules in this area have been laid down in art. 9a of CIT Act and in art. 25a of the PIT Act. By virtue of the said regulations, beginning from the year 2001, the obligation to prepare and store the relevant tax documentation has been imposed on taxpayers carrying transactions with related entities, both operating in Poland and those who are foreign persons (entities) having the seat or residing in countries (territories) using the so-called harmful tax competition. This obligation also applies to Polish entities affiliated with other Polish entities or individuals residing in Poland. The obligation of related entities to document transactions arises when the value of the contract exceeds EUR 30,000 (services and intangible assets) or EUR 100,000 – if the value of the transaction does not exceed 20% of the share capital, or EUR 50,000 – in other cases. Lower threshold in the amount of EUR 20,000, requiring special documentation, is valid for transactions with companies from “tax havens”.[3] The said documentation should particularly include such elements as: the determination of 1) functions to be fulfilled by the entities participating in the transaction, 2) anticipated expenses associated with the transaction, 3) method and manner of calculation of profits resulting from the transaction, and 4) economic strategy in cases where the value of the transaction is influenced by this strategy. The obligation to prepare the documents does not apply to all transactions, but only to those referred to in the Act. The economic operator is not obliged to submit this documentation to the tax authorities ex officio, but it is obliged to provide the documents at the request

[3] See: The Regulation of the Minister of Finance of 23.04.2015 on determining countries and territories applying harmful tax competition in terms of legal persons’ income tax (Dziennik Ustaw from 2015, item 600) and the Regulation of the Minister of Finance of 23.04.2015 on determining countries and territories applying harmful tax competition in terms of natural persons’ income tax (Dziennik Ustaw from 2015, item 599). Each Regulation specifies 31 countries and territories, including Barbados, Granada, Hongkong, Makau, Mauritius, Panama, Samoa and Seychelles, Virgin Islands as well as European countries and territories, such as Andorra, Liechtenstein and Monaco. The preparation of the list of countries applying harmful tax competition means that business transactions with entities located on the territory mentioned on the list are under a special supervision of tax authorities.

of those bodies within 7 days of the receipt of the request. In the event of failure to do so, shall the tax authority estimate the income under the terms of art. 11 of the CIT Act or in art. 25 of the PIT Act and shall the income estimated in this way be higher than the income declared by the taxpayer, the thus determined difference in the income will be taxed at the rate of 50%.

In accordance with these tax regulations, the tax authorities investigating transactions between related entities are entitled to use the so-called comparable uncontrolled price method to estimate the income in the case of suspicion of shifting income from Poland to a different country or to a taxpayer entitled, among others, to special income tax reliefs. It involves the direct comparison of a given transaction with the average prices applied in a particular place and on a particular day for similar transactions. Since 1 January 1997, as a results of Poland's accession to the OECD and following the subsequent changes in tax law, other methods used by other OECD countries, such as reasonable margin method ("cost-plus"), resale price method and two transactional profits methods, i.e. profit distribution method and transactional net margin method have been introduced into the tax system[4] (see Table 1).

Table 1. Methods of estimating income in transactions between related entities

Method	Description
1	2
Comparable uncontrolled price method	The most direct way of determining whether the taxpayer's income obtained as a result of the transaction was estimated based on the market value is to compare the prices of goods and services being the subject of the transaction concluded by affiliated companies with the prices applied in comparable transactions concluded by independent companies. The following factors may be used in order to make such a comparison: 1) prices of comparable transactions concluded by a taxpayer with unrelated entities, 2) prices used by independent entities in transactions with a taxpayer, 3) prices established in comparable transactions concluded between independent entities. The use of this method is conditioned by finding a transaction that could be considered comparable, i.e. the case where the physical characteristics of the subject of the transaction as well as its circumstances and conditions are identical or almost identical as in the case of a transaction being examined, and any slight differences do not affect the established price.
Resale price method	The resale price method consists in reducing the price of goods resold to an independent entity purchased in advance from a related entity by the value covering resale costs and a reasonable transactional profit. The price obtained after deducting the value referred to, called

[4] It is worth mentioning that Poland is one of the few countries that decided to introduce two transactional profit methods. Most countries limited the meantime, for application to their system of tax law only one method [Wyciślok 2014, p. 155].

1	2
	resale price margin, should be regarded as the market sales price which would apply in the primary transaction between independent entities.
Reasonable margin method (“cost-plus”)	An open-market price in a transaction carried out between related entities can be determined by increasing the costs incurred by the supplier of goods and services by a specified margin covering reasonable supplier’s profit in the light of the functions performed thereby and market conditions. A margin instrument used in the “cost-plus” method makes it possible to indirectly examine the correctness of the price established in transaction between related entities resulting with a profit. In order to determine whether the price established in sales transaction results from the market value, it is examined whether it corresponds to the sum of the three values: 1) costs incurred by the supplier of goods or services directly related to the acquisition or the production of the subject of the transaction, 2) a reasonable supplier’s profit in the light of the functions performed thereby and market conditions, 3) indirect costs minus the general management costs.
Profit distribution method	Profit distribution method shall be applicable in the event of a series of interconnected transactions which cannot be assessed independently. Using it eliminates the effect on the profit exercised by special conditions, agreed or imposed in a transaction or transactions between related entities through the determination of such a profit distribution awaited by independent companies participating in a comparable transaction. The profit distribution method makes it possible to determine total profits achieved by the affiliates when carrying out a given transaction or a series of transactions and to distribute the profits between them in the same proportion in which would be used by independent entities.
Transaction net margin method	Transactional net margin method consists in examining the net profit margin conducted by an entity in a transaction or a series of transactions with an affiliated entity. This margin is determined by deducting costs incurred to achieve it from the income generated by the transaction, including management costs in the amount taking into account the proportion of this profit in relation to the total income. The amount of margin determined in the above way should be set at a level of margin obtained by the same entity as a result of transactions with independent entities or in relation to the margin obtained in comparable transactions by independent entities.

Source: own study based on: [Krzewski, Michalak 2000, pp. 59–88].

It should be noted that as a result of amendments to the regulations on transfer pricing, since July 18, 2013 the existing solution based on the preference comparable uncontrolled price method has been replaced by the introduction of criteria for selection of a particular method of estimating the tax transfer pricing and levelling in the hierarchy of the use of all these methods.[5] The tax authorities make a decision on the choice of method taking into account criteria such as the course of the transaction (including the functional analysis), the availability of reliable information on comparable transactions or entities. Transaction-based methods (the CUP method, the cost plus method, and the resale price method) are still preferred; if those methods are inappropriate, profit-based methods are applied. Furthermore, in accordance with the regulations, if the taxpayers properly justify their selection of the applicable methods, authorities may need to estimate or just accept this solution.

In 2014, the tax authorities conducted an increasing number of transfer pricing audits. The tax authorities are frequently investigating not only the taxpayer's transfer pricing documentation, but also the actual terms of the intercompany transaction, including the calculation of prices and the profitability of the related parties. Moreover, several court rulings issued in 2014 indicate that the analysis justifying the arm's length character of prices applied is essential as a formal part of the transfer pricing documentation.

These regulations are a kind of instruction for the tax authorities, as it determines the rules and procedures of these bodies in cases of the finding or reasonable suspicion of shifting the income by related entities of which one or more is particularly dependent on an entity to which the income has been shifted. Descriptions of more than 20 methods of calculation of the prices of goods and services can be found in the economic literature. However, in cases provided for by the law, the Polish tax authorities determined the value of the transaction and consequently the taxpayer's income usually by applying the comparable uncontrolled price method or the transactional net margin method.[6] It should be added that, if the taxpayer used one of the so-called traditional methods, i.e., the comparable uncontrolled price method, the

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[5] See: Regulation of the Minister of Finance of 10.09.2009 on the manner and procedure of determining natural persons' incomes by estimation and the method and procedure for the elimination of double taxation of natural persons in connection with the adjustment of profits related entities [Rozporządzenie Ministra Finansów, Dz.U. 2014 poz. 1176] and Regulation of the Minister of Finance of 10.09.2009 on the manner and procedure of determining legal persons' incomes by means of estimation and the method and procedure for the elimination of double taxation of legal persons in the adjustment of profits related entities [Rozporządzenie Ministra Finansów, Dz.U. 2014 poz. 1186].

[6] The rules on the use of the cited methods are used in case of individuals (and legal persons respectively), if: 1) domestic entity participates directly or indirectly in managing another domestic entity or its control, or has a share in the share capital of another domestic entity, or 2) the same natural or legal persons at the same time directly or indirectly participate in managing domestic entities or their control, or have shares in the share capital of these entities. These provisions shall also apply to relationship of a family nature or resulting from the employment and matrimonial relationships between domestic entities or persons in managerial of supervisory roles and if any person combines managerial and supervisory functions in these entities. Shareholding in the share capital of another entity means a situation where a given entity directly or indirectly has a share of no less than 5% in the capital of another entity (*nota bene* from 2017 it will be 25%). When determining the share of indirect share of an entity in the capital of another entity, as a rule, if one entity has a particular share in the capital of another entity and the latter has the same share in the capital of another entity, the first entity has an indirect share in the

resale price method or the reasonable margin method ("cost-plus" method) in order to establish the price in a transaction with a related entity, the tax authorities are obliged to apply the same method (provided that the data used in the calculation by the taxpayer do not give rise to any objection). However, in a situation where the use of traditional methods is inappropriate and the taxpayer has applied the transactional profit method, the tax authorities should apply the same method. Therefore, the use by both the tax administration and the taxpayer of the same instruments has a beneficial effect on the course of a possible audit and should support the taxpayers in justifying the prices used.

After the accession of Poland to the European Union, the Ernst&Young conducted the studies concerning the use of transfer prices by among 176 business entities in Poland.[7] The survey shows that the taxpayers are increasingly less likely to use other methods than those laid down in the regulations and are increasingly turning to the transactional profit methods (see Table 2). The main reason for this is a greater knowledge of transfer prices among the surveyed entities which effectively choose the methods the tax authorities are obliged to use as well [Ernst&Young 2004, pp. 16, 17]. According to these studies, the relatively high percentage of entities uses methods other than those specified in the regulations in order to establish the level

Table 2. The use of transfer pricing methods in practice (in %)

Transfer pricing methods	CUP[1)]	RPM[2)]	C+[3)]	PSM[4)]	TNMM[5)]	Others
Finished products	21	14	48	3	11	2
Raw materials	23	14	49	0	8	6
Services	20	5	57	5	7	7
Intangible assets	22	14	34	10	3	16
Research and development	0	4	64	14	7	11
Distribution of goods	5	23	48	5	11	8
Loans within the group	63	1	23	1	2	9
Other financial services	33	9	33	6	3	15
Others	20	10	20	10	10	30

[1)] CUP – Comparable Uncontrolled Price, [2)] RPM –Resale Price Method, [3)] C+ – Cost Plus, [4)] PSM – Profit Split Method, [5)] TNMM – Transactional Net Margin Method.

Source: [Ernst&Young 2004].

capital of the another entity in the same amount; if the values are different, the amount of a lower direct share shall be considered an indirect share.

[7] Among the respondents, 85% of companies belong to international capital groups, 13% to national capital groups (2% of respondents said they were not members of capital groups, which means that they are linked otherwise, e.g. personally). Companies which responded to the survey are mostly subsidiaries – 75% of surveyed companies, 20% of respondents are both subsidiaries and parent companies at the same time, and 5% – parent companies only.

of prices used by them. Alternative methods to those specified in the regulations are most frequently used in transactions involving intangible assets (16% of all cases of the use of alternative methods), other financial services (15%) as well as research and development (11%). Less typical nature of transactions in case which the entities have indicated the use of alternative methods of transfer pricing examination may indicate that these methods were chosen due to the difficulties encountered when attempting to use the methods specified in the regulations.

Current trends show that the times in which regarded transactional profit methods for rarely used in economic practice, gone. It suggests even that their use leads to more precise results than using traditional methods. This will occur mainly in the case of transactions of a special, unique object, or if the entities' activities of the controlled transaction will strongly inter-linked, and finally when there is no publicly available and reliable data on the gross profitability of others. Of particular importance will be especially the latter case, because finding a suitable reference material is a fundamental problem when using traditional methods.

The growing popularity of transactional profit methods involves certainly the fact that in order to use them is not necessary to be made complicated and thorough comparative analysis. There is not also the need to ensure perfect comparability of the subject of the transaction. They require data comparability much less than the traditional methods and allow for considerable subjectivity in the assessment of the controlled transaction conditions. [Wiśniewski, Komer 2012, p. 26]. By contrast, will be crucial for the application of these methods to ensure comparability of the economic conditions under which exists and operates taxpayer [Michalski, Rosińska 2009].

The use of more complicated methods by the taxpayers, such as transactional profit methods, may indicate an increase in understanding transfer pricing methods and the rise in popularity of this method may be a sign of a good preparation of taxpayers to justify the price level in the case of more unusual transactions the analysis of which using traditional methods proved impossible

But still the most common method used by the companies is the reasonable margin method ("cost-plus" method). The cited study shows that the percentage of companies establishing prices based solely on this method varies depending on the type of transactions from 23% for transactions of granting loans to 64% for research and development. When reviewing the most common methods and the most appropriate ones for particular types of transactions according to textbooks, it should be borne in mind that it is necessary to perform a thorough analysis in order to select the best one for a given transaction. It may turn out that theoretically the best method for a given transaction is inapplicable in a particular case for various reasons. For example, high percentage of entities (49%) use the reasonable margin method ("cost-plus" method) for transactions relating to raw materials, although the comparable uncontrolled price method is theoretically more appropriate for this type of transactions. This may result from the fact that there are difficulties in access to information used to identify comparable transactions between unrelated entities (which are generally the most common barrier to using this method). The high popularity of the "cost-plus" method was observed in the results of a global study conducted by Ernst & Young. 57% of surveyed companies (similarly to Poland) use this method in respect of the transactions related to the provision of services. In contrast, this method is used less frequently than in Poland in case of transactions related to finished products (31% worldwide, in Poland – 48%). Worldwide, they are much more often valued using the comparable uncontrolled price method (35% worldwide, 21% in Poland) [Ernst&Young 2004].

In practice, the use of a particular method is determined by the possibility of obtaining comparative data concerning, among others, the subject of such transaction and the entities performing them (and a number of others). Sometimes, the scope of collected information and comparative data is so wide that it makes it possible to use two methods at the same time, i.e. the comparable uncontrolled price method and one of the others. The regulations explicitly define the issues to be taken into account by the tax authorities in order to use estimating techniques referred to in the regulations of the Act in case of a particular type of transactions. These regulations indicate which comparative data shall be accessed by tax authorities and what shall be taken into account in order to properly use, e.g., comparable uncontrolled price method. This is even more important since in the case of these particular transactions between related entities the main condition for the proper estimation of income derived therefrom should be met, i.e. conditions to be agreed between independent operators in case of such a transaction should be laid down.

In October 2015 the Polish Parliament made changes to the laws on income taxes (CIT and PIT), which generating a completely new regulations on tax documentation. This amendment is the result of the work to roll in the framework of the OECD on combating the erosion of the tax base and shifting of income (i.e. BEPS). This resulted in the need to adapt existing regulations to the recently developed international standards. From 2017 the amendment introduces hitherto non-existent distinction documentation requirements depending on the size of taxpayers. The larger the scale of activity, the more responsibilities. Consequently, the smallest taxpayers whose income or expenses did not exceed in the year preceding the tax year, the equivalent of EUR 2 million, they will not have to prepare tax documentation. This is favourable change – bigger taxpayers will not have to document transactions relatively unimportant compared to the scale of their operations. Exceeding the threshold of EUR 2 million will cause the obligation also in the next fiscal year, even when the amount of revenue in the year for which the taxpayer was obliged to produce documentation was lower. This means that each exceeded the threshold of EUR 2 million in revenues or expenses will be required to draw up documents for at least 2 consecutive fiscal years.

4. The APA agreement as a way to reduce the tax risk in the activities of related entities

In most developed countries, there are mechanisms that allow for a fairly effective control over transfer pricing. In OECD countries, especially in the US, the situations which did not reflect the market reality and were related to the settlement between the related companies have been regulated with relevant regulations many years ago. These regulations also defined the methods of interventions of tax authorities and the procedures in the case of transfer pricing. In these countries operate special offices at tax offices, there are special instructions on how to evaluate reports of companies suspected of transferring their income. In order to eliminate transfer pricing and income shifting, the principle of "arm's length" is adopted. It means that the prices between related companies should be determined is such a way as if these companies were independent of one another, acting in similar market conditions. The rules on transfer pricing are aimed at protecting the tax base in individual countries of economic gain [Szarpak 2006, p. 20].

In order to avoid questioning the level of prices in transfers between related entities are used in the agreement between the taxpayer and the tax authorities, i.e., the Advance Pricing Agreements (APA). It is a kind of agreement with the tax authorities used by the taxpayer methodology for determining those prices. For the first time, these procedures have been introduced in the US in 1991. The APA may be unilateral, i.e., contained between the taxpayer and the tax authorities, and bilateral and multilateral, i.e., between the taxpayer and its foreign entity and foreign tax authorities. In bi- and multilateral negotiations take part tax administrations of the countries in which are the seats of the agreement entities. Therefore diverse is the range of procedures for unilateral agreements and bilateral and multilateral. The sided agreement includes the conditions laid down by the tax administration of the country, while other types of agreements are based on the mutual agreement procedure which is stated in Article 25 of the OECD Model Tax Convention and in the applicable bilateral agreements for the avoidance of double taxation.

The APA procedure consists of the subsequent stages, i.e.: 1) lodging of an application for granting APA.[8] 2) verification and final evaluation of information provided by a taxpayer, 3) conclusion and implementation of the agreement, 4) monitoring of the agreement. It should be added that bi- and multilateral agreements are the forms of APA agreements which are preferred by OECD, since the unilateral agreements are a partial solution, applicable only at the local or national level, boiling down to the confirmation of accuracy of the price calculation method adopted by the taxpayer in transactions covered by this agreement. Therefore, there is no certainty as to the

[8] At this stage, each taxpayer must attach to the application all data and documents that will enable tax authorities to assess the methodology proposed by the taxpayer, which should be consistent with the principle of the free market.

approach in this area by other tax authorities and thus the adoption of such an unilateral solution does not limit the potential risk of double taxation.[9]

This type of agreement specifies transactions or segments of production which are covered by the agreement, but it is not required to make all related entities or all transactions between these entities covered by such agreements. Their essence is to agree on the methodology of transfer pricing and to define an acceptable result. For example, if the approved method of resale price determines the percentage of margin recognized to be compatible with the principles of the free market, the agreement gives the taxpayer comfort that the transfer prices used by him/her will not be questioned by the tax authorities and allows to avoid burdensome inspections on transfer pricing. Thus, the main benefit resulting from the APA agreements is having confidence by the taxpayers who have entered such an agreement as to the tax consequences associated with transactions with related entities which are the parties of this agreement. However, it should be noted that the conclusion of the agreement means also making certain data, which often constitute the company secret and could not be used during a tax audit without concluding the agreement, available to the tax authorities. Data made available during the negotiations are protected in accordance with the OECD standards and can be used neither in the current nor future tax proceedings. Such an agreement is concluded usually for a period of 3 to 5 years and may be extended (using the extended procedure) for a similar period of time. As long as the taxpayer meets the requirements set out in this agreement, the tax authorities cannot question the transactions covered thereby. As a rule, these agreements relate to future events, but they also foresee the possibility of the use thereof in relation to the past taxable periods (*rolling back*) that have not yet been the subject of inspection carried out by the tax authorities, in relation to which the limitation period for tax liabilities has not passed. However, in this case, the use of a specific methodology adopted within the framework of the APA agreement refers to a situation in which both the past transactions and those covered by the current agreement do not show significant differences [Szarpak 2006, p. 26]. The APA agreements are used, among others, in Australia, Belgium, China, Finland, France, the Netherlands, Japan, Canada, Mexico, Germany, Slovakia, the United States and Great Britain, although the scope of the application thereof and the practice vary from country to country.

As of 1 January 2006, the relevant regulations of the Tax Ordinance Act[10] governing the issue of binding agreements on prices, following the pattern of the long-established agreements existing in many countries of the world, became applicable in Poland. The regulations of the amended Tax Ordinance Act give income-tax-payers the possibility to conclude tax agreements with tax authorities on establishing and

[9] For example, in such countries as the Netherlands, France and Great Britain, bilateral and multilateral agreements are preferred, although in the Netherlands and Great Britain unilateral agreements are used as well. See: [Kubińska, Olejnik 2004, p. 24].

[10] See: art. 20a–p of the Tax Ordinance Act [Ustawa z 29 sierpnia 1997].

agreeing the correctness of transaction prices used in case of operations carried out between entities affiliated personally or in capital. These regulations are expected to lead to an increase in tax certainty of domestic trade which should translate into the improvement of the confidence promoting investing in Poland by foreign entities. A greater degree of certainty in planning prices in transactions between related entities is one of the most important issues for international companies planning their investments in Poland as well as an important tool to enhance the certainty of investing for Polish companies. This tax-law institution allows taxpayers to avoid potential disputes with tax authorities arising out of transfer prices used in transactions between related entities. The taxpayer is able to propose a transfer pricing method and apply it in practice upon the Minister of Finance's approval. As in other countries using such agreements, they are unilateral,[11] bilateral and multilateral. In case of unilateral agreements, tax authorities of foreign countries are not to participate therein, which means that such agreements shall not prevent possible risks relating to double taxation. A procedure related to the conclusion of such agreements shall last no longer than 6 months and the fee for the conclusion thereof shall amount from PLN 5,000 to PLN 50,000 if only domestic entities, if only national entities will be bound thereby or from PLN 20,000 to PLN 100,000, shall the agreement concern a foreign entity. In both cases, however, it shall be no more that 1% of the value of transaction being the subject of the agreement.

Bilateral agreements depend on the method of establishing transaction prices, recognized by the Minister of Finance and selected for the purposes of certain transactions between domestic and foreign related entities.[12] The condition for the conclusion of such an agreement is a prior consent from the competent tax authority of the foreign entity affiliated with the domestic one to use the method of establishing transaction prices which is indicated in the application. Proceedings concerning the conclusion of this type of agreement is to last up to 1 year and shall be subject to a fee from PLN 50,000 to PLN 200,000, but not more than 1% of the value of the transaction being the subject of this agreement. However, in the case of a multilateral agreement, i.e. when the price agreement applies foreign entities from more than one country, its conclusion requires the approval of the tax authorities competent for foreign entities which are to participate in the transaction. The entire proceeding concerning the multilateral agreement is to last no longer than 18 months and shall be subject to a one-time fee from PLN 50,000 to PLN 200,000, but not more than 1% of the value of the transaction being the subject of this agreement. The regulations of the Tax Ordinance Act also define the rights and obligations of the entities applying

[11] An unilateral agreement is an agreement between: 1) related domestic entities, 2) domestic entities affiliated with a foreign entity and the foreign entity or 3) a domestic entity affiliated with a foreign entity and other domestic entities affiliated with the same foreign entity.

[12] According to art. 20b of the Tax Ordinance Act [Ustawa z 29 sierpnia 1997].

for the price agreement.[13] In Poland, according to art. 20c of the Tax Ordinance Act, a price agreement may cover the transactions to be conducted following the lodging of an application for establishing an agreement as well as the transactions implemented before the date of lodging the application. Shall the tax authority competent for the foreign entity does not approve the conclusion of the agreement or if there is a reasonable likelihood of denying such an approval within 6 months from the date of lodging the application, the competent authority will the applicant thereof. The fee for an application for the extension of the validity period of a decision concerning the agreement shall be half of the fee due for the application for the conclusion of the agreement. The prolongation of the validity period of a decision regarding the agreement shall take place by means of a decision. Validity period of a decision concerning the agreement cannot be longer than 3 years. This time limit may be extended at the request of a related entity, submitted not later than 6 months before the expiry of that period, if the criteria of a transfer pricing method to be used by related parties have not changed.[14] Extended validation period of a decision cannot be longer than the next three years. In the case of a change of economic relations resulting in gross inadequacy of the choice and the use of a transfer pricing method considered correct,

[13] An entity applying for the conclusion of the agreement is obliged to submit: 1) proposal of a transfer pricing method, especially by indicating one of methods referred to in the provisions concerning corporate income tax or personal income tax, 2) description of how to apply the proposed method with respect to the transaction which is to be the subject of the agreement, in particular to specify: the principles of calculation of a transfer price, financial projections on which the calculation of a transaction price is based, analysis of comparative data used to calculate a transaction price, 3) circumstances that may affect the proper determination of a transaction period, especially: the type, subject and value of the transaction to be subject of a domestic agreement; the description of the course of the transaction, including an analysis of assets, functions and risks of transaction parties and the description of the economic strategy of the parties and other circumstances, if the strategy or circumstances have an impact on the price of the subject of the transaction; data on the economic situation in the industry in which the applicant operates, including data on business transactions carried out by unrelated entities used to prepare the calculation of the transaction price; organizational and capital structure of the applicant and its affiliated entities being a party of the transaction and the description of the financial accounting rules applied by the related entities, 4) documents having a significant impact on the transaction price, especially the texts of contracts, agreements and other documents indicating the intentions of the parties to the transaction, 5) proposal of an agreement period, 6) list of affiliates to participate in the transaction, including their consent to the submission of all documents relating to the transaction to the authority competent for the agreement as well as to provide necessary explanations.

[14] In this case, within 30 days of receipt of the notification, the applicant will be able to: 1) withdraw the request for an agreement, provided that half of the fee paid has been returned, 2) change the request for a bilateral agreement to the request for an unilateral agreement – provided that a quarter of the fee paid has been returned, 3) change request for a multilateral agreement to the request for bilateral agreement, if the tax authority of only one country agrees to the conclusion of an agreement – provided that a quarter of the fee paid has been returned or 4) accept the conclusion of a bi- or multilateral agreement without taking into account the affiliated foreign entities to which the obstacles without changing the amount of the fee apply.

the decision concerning the agreement may be amended or repealed by the authority competent for the agreement before the expiry of its validity period.

APAs are an effective dispute resolution option, but a heightened risk environment and resulting double taxation concerns may be driving increased interest in the APA process. Twenty-six percent of parent companies surveyed reported using an APA in 2012, up from 21% in 2007. Fifteen percent reported using bilateral APAs, and 14% reported using unilateral APAs. Just 2% reported using multilateral APAs. The level of satisfaction with the APA process remains high (79% of parent companies) — slightly higher, in fact, than reported levels of satisfaction with the transfer pricing documentation process itself (76%). Again, as with transfer pricing documentation, the length of the process was the primary source of dissatisfaction. Of those dissatisfied with the APA process, 89% cited the length of time required to complete as the primary source of dissatisfaction [Ernst&Young 2013b].

5. Conclusions

Any business entity operates within the strict framework of legal, institutional, economic, political and social structures of a given country. Due to the impact of external factors on the company, including tax policy, can be less or more effective and the goals achieved by them more or less real. The task of public authority is to create regulations to make the environment of the company as favourable as possible and support economically viable projects.

The tax regulations discussed are intended to reduce the incidence of shifting the profits between affiliated companies. In the current economic environment, it is not an easy task, since the benefits accruing from this practice are significant. Therefore, the temptation to use the mechanism of transfer pricing is high. Certainly, reducing the tax burden and simplifying the tax system should promote the elimination of such practices from the polish economic life. However, this is not an antidote against a certain group of entities, which in all circumstances will try to lower their income and conceal it from tax administration of a given country by manipulating transaction prices. It is therefore important to create both mechanisms and procedures that would eliminate unfair market players and promote economically efficient ones.

Entrepreneur-friendly changes in corporate tax law and favourable political climate are conducive to the creation of transnational form of economic activity. The primary purpose of these transnational economic organisms – just like in the case of most forms of economic activity – is to achieve maximum benefits possible by making full use of the opportunities offered by the globalization.

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