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Application of 50% Tax-Deductible Costs to Income Earned from Creative Activity in the Area of Computer Programmes – a Critical Review of New Regulations

Abstract

Introducing Article 22, section 9b, item 1 into the Personal Income Tax Act of 26 July 1991 using terms that have not been defined in this Act and not specifying the provisions of other acts of law which would become the grounds for defining these terms, thereby creating a normative condition for applying 50% tax-deductible expenses to income arising from activities performed by IT employees, the lawmakers failed to observe the requirement of correct legislation determined by the Constitutional Tribunal in its judgements, creating a law that is vague and imprecise, and gives the entities applying it a sense of uncertainty about whether they apply the provisions of the Personal Income Tax Act correctly.

Keywords: tax deductible costs, personal income tax, creative activity, computer programmes

1 PhD Wojciech Dmoch – e-mail: wojtek.dmoch@gmail.com; ORCID: 0000-0002-3414-8850.

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WOJCIECH DMOCH

Stosowanie 50% kosztów uzyskania przychodów z tytułu działalności twórczej w zakresie programów komputerowych – krytyka nowych przepisów

Streszczenie

Wprowadzając art. 22 ust. 9b pkt 1 do ustawy z dnia 26 lipca 1991 r. o podatku dochodowym od osób fizycznych ustawodawca stosuje pojęcia, których znaczenia rzeczona ustawa nie określa i nie wskazuje przepisów innych aktów prawnych, które miałyby stanowić podstawę do określenia wspomnianych pojęć. W konsekwencji pojawia się sytuacja, w której stosowanie 50% kosztów uzyskania przychodów do pracy wykonywanej w obszarze technologii informacyjnych staje się normą; ustawodawca nie uwzględnił zasad prawidłowej legislacji określonych w orzeczeniach Trybunału Konstytucyjnego. Prowadzi to do powstania prawa, które okazuje się niejednoznaczne, nieprecyzyjne i które wywołuje wśród podmiotów stosujących je w praktyce poczucie niepewności co do prawidłowości interpretacji postanowień ustawy o podatku dochodowym od osób fizycznych.

Słowa kluczowe: koszty uzyskania przychodów, podatek dochodowy od osób fizycznych, działalność twórcza, programy komputerowe

New regulations regarding 50% tax-deductible expenses in the Personal Income Tax Act of 26 July 1991[2] ("the PIT Act") became effective on 1 January 2018.[3] According to these regulations, 50% tax-deductible expenses (in the maximum amount determined under Article 22, section 9a of the PIT Act) are applied to income earned by authors from the exercise of copyright – in the meaning of the copyright law – or the regulations on such rights (Article 22, section 9, item 3 of the PIT Act). This applies, however, only if this income arises from creative activity with regard to computer programmes (Article 22, section 9b, item 1 of the PIT Act).

The author of the new regulations did not specify the guidelines they followed when making these changes because the justification of the bill[4] regarding the new regulations on the application of 50% tax-deductible expenses refers only to an increase in these expense (the maximum annual limit of 50% tax-deductible expenses in 2018 is PLN 85,528), which is, after all, not an oversight since the original bill amending the Personal Income Tax Act does not have a new Article 22, section 9b, item 1. And the amendments to Article 22, section 9a apply precisely to an increase in the limit of the expenses in question.[5] It can only reasonably be assumed that these regulations apply to the emphasis of the creative nature of the work of IT employees as a condition for benefiting from the 50% deduction of expenses.

Such conclusions arise from the fact that apart from the condition that existed under the previous wording of the PIT Act, which had to be satisfied in order to benefit from the 50% tax-deductible expenses, i.e. that income must be earned from the exercise of copyright by authors in the meaning of the copyright law, or the regulations on such rights, a new condition was specified in Article 22, section 9b, item 1 of the PIT Act:

- income must be earned as a result of creative activity in the area of computer programmes.

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[2] Consolidated text Dz.U.2018.200 of 24 January 2018.

[3] The changes were introduced by the Act on the amendment of the Personal Income Tax Act, the Corporate Income Tax Act and the Act on the lump sum income tax on certain income generated by natural persons of 27 November 2017 (Dz.U.2017.2175 of 27 November 2017).

[4] Sejm form No. 1878.

[5] This is because Article 22, section 9b appeared at the stage of work in the Public Finance Committee – Sejm form No. 1943.

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Therefore, in order to determine whether 50% tax-deductible expenses apply to income arising from the activities performed by a given IT employee, an analysis needs to be performed to prove that:

- the employee created a copyrightable work within the meaning of the copyright law. This analysis is necessary to determine that a given employee's income is earned from the exercise of copyright by authors within the meaning of the copyright law, or the regulations on such rights;
- if the employee created a copyrightable work within the meaning of the copyright law, it would need to be proven that the copyrightable work created is a creative activity in the area of computer programmes.

Although Article 22, section 9, item 3 of the PIT Act refers to "copyrights" and "authors", the provisions of this Act do not contain a definition of these notions and refer in this respect to separate regulations, which should be understood as the provisions of the Act on copyright and related rights of 4 February 1994[6] ("Copyright Law"). According to Article 1, section 1 of the Copyright Law, the subject matter of copyright is any manifestation of creative activity of an individual nature, established in any form, regardless of the value, purpose, and manner of expression.

Therefore, in order to establish that a specific piece of work is a copyrightable work, it must be:

a) a result of human work;
b) creative (the result of this work is new, different from the results of the same activity). As held by the Court of Appeal in Poznań, in the judgement of 7 November 2007 (case reference I ACa 800/07), "the conclusion that a work is a manifestation of creative activity means that the work should be the result of activity of a creative nature. This condition, sometimes referred to as the condition of 'originality' of the work, is achieved when there is a subjectively new product of intellect", and
c) of an individual nature (unique and not having an equivalent in the past).

The second element, the fulfilment of which determines the possibility of applying 50% tax-deductible expenses to the earnings of IT employees for their transfer of copyrights to the works produced, pursuant to Article 22, section 9, item 3 and Article 22, section 9b, item 1 of the PIT Act, is that IT employees need to perform creative activities in the area of computer programmes. This is because, as provided in Article 22, section 9b item 1 of the PIT Act, the provision of Article 22, section 9, item 3 of this Act is applied to income earned from creative activity in

6 Consolidated text Dz.U.2017.880 of 5 May 2017.

the area of computer programmes. Although the PIT Act uses the term "computer programmes", it does not offer a definition of this term. Furthermore, the term "computer programmes" is not defined in the copyright law, which protects computer programmes as literary works (Article 74, section 1 of the Copyright Law). However, Chapter 7 of the Copyright Law does cover computer programmes. The provisions of Chapter 7 of the Copyright Law implement Council Directive 91/250/EEC, later superseded by Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programmes ("Directive 2009/24/EC") into the Polish legal system. Although the entire chapter covers the issue of computer programmes, the provisions of the Copyright Law do not define the term "computer programme", which duplicates the assumption made in Directive 2009/24/EC, because it was pointed out in the explanatory memorandum to the first draft of this directive that the definition of the term "computer programme" is not necessary, while its inclusion in the directive could bring about its excessively rapid obsolescence as a result of progress in information technology. The explanatory memorandum only states that "according to the current state of knowledge, 'programme' should be understood as an expression in any form, language, notation or instruction set code, which is intended to enable a computer to perform a specific task or function". According to legal doctrine, "under the Polish law, there are no grounds for a computer programme to be understood fundamentally differently from the definition cited in the explanatory memorandum. [...] For the purposes of the Act on copyright and related rights, a computer programme can therefore be defined as: a) a set of instructions (orders, commands), b) addressed to a computer, c) the fulfilment by the computer of which leads to the achievement of specified results."[7] Consequently, only an action performed by an IT employee which involves creating a set of instructions (commands) addressed to a computer and the execution of which by the computer leads to specific results can be considered a copyrightable work.

Tax remitters (employers) addressed the tax authorities in 2018 to obtain tax rulings confirming that they were allowed to apply 50% tax-deductible expenses to the income of their employees performing IT work. The above relationship between the PIT Act and the Copyright Law implies that creative activity in the area of computer programmes means the creation of a set of instructions (commands) addressed to a computer the execution of which by the computer leads to specific results and that only such a computer programme is protected by the copyright law, the use or exercise of which may create income subject to 50% tax-deductible expenses. In the light of the above – and considering that the objective of the new

[7] D. Flisak (ed.), *Prawo autorskie i prawa pokrewne Komentarz*, LEX 2015.

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regulations of the PIT Act was to emphasize creative activity in the area of computer programmes – it could be assumed that the rulings would at least discuss this issue, even if they focused on other aspects of applying the 50% tax-deductible rate. However, none of the rulings addressed the matter of how creative activity and computer programmes should be understood, and focused only on aspects which were also considered under the previous wording of the PIT Act, when Article 22, section 9b did not exist. According to these rulings:

- if the provisions of the employment contract and the records kept by the tax remitter (the employer) make it possible to determine clearly the part of the fee to which the transfer of the copyright applies and the part that applies to the remaining employment activities, the fee being the royalties for the transfer of the copyright to the Applicant will be set based on the amount in question (the amount of the fee will determine the actual value of the work, i.e. based on the time devoted to the creation of the work, the utility value, the quality, complexity, and potential market value), when calculating and paying personal income tax, the employer may apply the 50% rate to tax-deductible expenses to the part of fee for the transfer of copyright;[8]
- keeping records of the work time spent on the production of individual works and the specification of the level of the royalties on the basis of the number of hours spent by the employee on the creation of the works does not give grounds for applying the 50% tax-deductible rate on 2 May 2018;[9]
- there are no provisions under the PIT Act to specify the correct meaning not only of the terms "author" or "copyright", which can be justified by the references made here to separate regulations, but also of the notions of "creative activity" and "computer programme".[10]

Two conclusions can be drawn regarding the nature of the new regulations on the basis of these arguments, which are also representative of other rulings of the Director of the National Fiscal Administration Office issued as responses to enquiries submitted by remitters of personal income tax and formulated on the basis of the provisions of the PIT Act, which entered into force on 1 January 2018, i.e. the new wording of Article 22, section 9, item 3 of the PIT Act and the new Article

8 According to the ruling of the Director of the National Fiscal Information Office of 17 May 2018 (No. 0113-KDIPT3.4011.144.2018.2.JR). Similarly: rulings of 8 May 2018 (No. 0115-KDIT2--1.4011.96.2018.1.AS) and of 27 April 2018 (No. 0114-KDIP3-3.4011.39.2018.2.IM).

9 Based on the ruling of the Director of the National Fiscal Information Office of 20 April 2018 (No. 0114-KDIP3-3.4011.66.2018.3.IM). Similarly: ruling of 1 June 2018 (0115-KDIT2-1.4011.82.2018.2.MK).

10 Based on the rulings of the Director of the National Fiscal Information Office of 1 June 2018 0115-KDIT2-1.4011.82.2018.2.MK and 8 May 2018 (No. 0115-KDIT2-1.4011.96.2018.1.AS).

22, section 9b, item 1 of the PIT Act. Firstly, the Director of the National Fiscal Administration Office does not refer to the issue of "creative activity in the area of computer programmes", namely the condition of taking advantage of the 50% deduction of expenses incurred. The Director claims that "they do not determine [...] the issue of the correctness of the actions under separate regulations (including the Act on Copyright and Related Rights)". Although Article 22, section 9b, item 1 is a part of the PIT Act and its correct understanding is a condition to apply the 50% tax-deductible rate, the Director of the National Fiscal Administration Office does not determine whether – in a particular case – the statutory condition arising from the provisions of the PIT Act have been satisfied because it is considered outside of their competence. Secondly, when assessing the correctness of the position of the personal income tax remitted regarding the ability of these remitters to apply the 50% rate to tax-deductible expenses to the remuneration they pay to IT employees who develop computer programmes, without considering in any way whether these employees obtain income from creative activity (the normative condition for applying the 50% tax-deductible rate under Article 22, section 9b, item 1 of the PIT Act), the Director of the National Fiscal Administration Office does not issue their ruling on the basis of the new provision of Article 22, section 9b, item 1 of the PIT Act. The basis of these rulings is, however, Article 22, section 9, item 3, the content of which in this respect is consistent with the previous legal situation. In other words, the tax authority does not focus on the new condition for applying the 50% tax-deductible rate, as introduced into the PIT Act from 1 January 2018, but on an element that was not introduced into the Act at that date because it existed earlier, namely, before 1 January 2018; it also arose from Article 22, section 9, item 3 that 50% tax-deductible expenses were due to authors for the disposal of their copyright. When issuing individual tax law interpretations and specifying the conditions that must be satisfied with respect to the salary which an IT employee receives from the employer for the disposal of their copyright, the Director of the National Fiscal Administration Office explains how, in their opinion, only Article 22, section 9b, item 3 should be interpreted.

The conclusions presented above lead to the questions of whether the subject of criticism should be precisely the quoted activity of the Director and whether the lawmakers who introduced the above Article 22, section 9b, item 1 into the PIT Act should be critically assessed in this case.

In my opinion, the criticism should be addressed primarily to the lawmakers. The approach where the Director of the National Fiscal Administration Office interprets the provisions of the PIT Act regarding the conditions that have to be satisfied with respect to the salary paid by employers to IT employees for the employees' disposal of their copyright is based on the case law of the administrative

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courts examining the legality of the decisions in this respect and is consistent with this case law.[11] Meanwhile, by introducing Article 22, section 9b, item 1 into the PIT Act on 1 January 2018, the lawmakers established a new, normative condition for the application of the 50% rate to tax-deductible expenses, indicating that these costs were only deducted from the employee's income which that employee earned for their "creative activities in the area of computer programmes". Unfortunately, when formulating this condition, the lawmakers not only did not define the concepts used, namely "creative activity" and "computer programme", but also failed to indicate the regulations of other legal acts on the basis of which the given activity should be considered creative activity and if such activity existed, whether it was conducted in the area of computer programmes. I believe that the wording used by the lawmakers in Article 22, section 9b, item 1 "the provisions of section 9, item 3 are applied to income obtained from creative activity in the area of computer programmes", where section 9, item 3 contains a reference to "separate regulations" – but only with regard to clarifying the notion of *author*[12] and the notion of *copyright* – is not a sufficient condition to accept that the notion of creative activity and computer programmes should be interpreted precisely on the basis of these "separate regulations" referred to in Article 22, section 9, item 3 of the PIT Act. The Constitutional Tribunal has repeatedly referred in its rulings to the need to formulate provisions of tax law in such a way that they are clear, specific, and understandable to their addressees.[13] The Tribunal has also emphasised that the formulation of provisions

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11 For example, the judgement of the Supreme Administrative Court of 11 March 2015, case ref. FSK 459/13: "It is insufficient to distinguish the part of the work time that is intended for creative work in the employment contract, because it does not transpire from this distinction whether the work was actually created and whether royalties were paid as a result of its use (see judgements of the Supreme Administrative Court of 12 March 2010, II FSK 1791/08; of 16 September 2010, II FSK 839/09 and of 29 April 2011, II FSK 2217/09). [...] this is because this requirement referred to the distinction in the salary of the part that constitutes the royalties for the transfer of proprietary copyright, regardless of the method of calculating that part of the salary. This requirement is not reflected in the calculation of the time spent by the employee on performing creative work. This is because the essence of creative work is that its result is uncertain, so spending a specified amount on time doing it does not determine that the intended effects in the form of the creation of a work have been obtained at all."

12 From the semantic point of view, since, according to Article 22, section 9, item 3 of the PIT Act, reference should be made to the copyright law in order to define the concept of "author", while an "author" is a person who creates and therefore performs creative activity, it should be accepted that a reference should also be made to the provisions of the copyright law in order to define the concept of "creative activity". However, since an "author" is a person performing creative activity and the 50% rate of tax-deductible expenses are only due to authors, it seems reasonable to ask what the objective of introducing the condition of creative activity was if this condition arose already from the wording of Article 22, section 9, item 3 of the PIT Act.

13 For instance, in the judgement of 3 December 2002, P 13/02, the Constitutional Tribunal held that: "The alleged lack of clarity, lack of sufficient specificity and intelligibility for the addressees as

of the law precisely and clearly is a requirement of correct legislation arising from the principle of the rule of law expressed in Article 2 of the Constitution of the Republic of Poland.[14] In view of the above, it can be reasonably assumed that when introducing Article 22, section 9b, item 1 into the PIT Act, by using terms that have not been defined in this Act and not specifying the provisions of other acts of law which would offer the grounds to define these terms, thereby creating a normative condition for applying the 50% rate to tax-deductible expenses, the lawmakers failed to observe the requirement of correct legislation, creating a law that is vague and imprecise, and gives the entities applying it a sense of uncertainty about whether they apply the provisions of the PIT Act correctly.

well as the serious interpretational doubts caused by the above should be considered of greatest importance from the point of view of the assessment of compliance of the contested provision with the principle of the rule of law expressed in Article 2 of the Constitution. The Constitutional Tribunal has repeatedly drawn attention to the need for the bodies appointed to legislate to respect the claim for clarity, specificity, and comprehensibility of the issued regulations. These claims are particularly important in the area of tax law, especially with regard to the regulations governing tax liability."

14 However, in the judgement of 29 October 2003, K 53/02, the Constitutional Tribunal held as follows: "The Tribunal consistently argues that the requirement for the lawmakers to observe the principles of correct legislation arises from the principle of the rule of law expressed in Article 2 of the Constitution. This requirement is functionally related to the principles of legal certainty and legal security as well as to the protection of confidence in the state and its law. These rules require that the provisions of the law are formulated in a precise, clear, and linguistically correct manner. The requirement of clarity means an obligation to create clear regulations which are understandable to their addressees, who can expect rational lawmakers to lay down legal norms that do not give rise to doubts as to the wording of the imposed obligations and awarded rights. The precision of a regulation related to clarity should manifest itself in the specificity of the imposed obligations and awarded rights so that their content is obvious and allows for their enforcement. The observance of the principles of correct legislation – as the Tribunal held in case K 33/00 – is particularly important with regard to rights and freedoms. When it comes particularly to tax regulations, the lawmakers cannot leave the bodies that need to apply them with excessive freedom to define their scope with respect to entities and activities – so as not to leave taxpayers with uncertainty regarding their obligations, which could result from a vague formulation of the wording of the regulations in question. Exceeding a certain level of ambiguity in the provisions of the law can become a reason to conclude that they do not comply with the principle of the rule of law expressed in Article 2 of the Constitution, from which the requirement of appropriate specificity of the provisions that are laid down arises."

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