GARRIGUES
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REAL ESTATE

Influence of defects in premises on the possibility of early termination of lease agreements

The increasing growth in the office and warehouse construction industry and an oversupply of available space has resulted in lower rent and greater competition amongst landlords. The increased availability of premises encourages tenants to renegotiate lease agreements and search for new locations. What complicates the tenants' situation is that commercial lease agreements are concluded for fixed periods of time, which obstructs their termination in the event the contract does not contain the relevant provisions.

Inability to exercise the right to terminate a lease agreement concluded for a fixed term is a reason why tenants increasingly choose to rely on article 682 of the Civil Code (CC), which states that if defects in leased premises are such that they pose a danger to the health of the tenant, the members of his/her household or the persons employed, the tenant may terminate the lease agreement without notice, even if the defects were known at the time the contract was signed.

Since the regulation described above is mandatory and therefore cannot be amended or repealed, it is worth taking a closer look at it and how it is practically enforced, in light of current case law.

Read literally, article 682 CC gives broad powers to tenants. Accordingly, lease agreements can be terminated in the event defects exist that actually pose a threat to persons employed by the tenant. No effects are necessary, other than the actual threat itself. Furthermore, it does not matter when the defects occurred and whether the tenant knew about them when entering into the lease agreement. Therefore, confirmation of the poor condition of premises in the lease agreement will not prevent the enforcement of rights under article 682 CC.

In addition, article 682 states that the defects in the premises do not have to be objective. A defect that causes an allergy to an employee, but does not affect others will be sufficient. Moreover, the provision does not regulate the scope of danger required to terminate the lease agreement. The defects can affect only part of the building where the premises are located and do not have to affect other tenants. According to case law, the defects that can be considered as grounds for termination are: moisture, mould, excessive noise, vibration, the appearance of liquid or gas leaks, inappropriate temperatures, and the danger of collapse or use by the construction company of materials that emit toxic substances. In the event of a dispute, each of the above circumstances will have to be duly proven. To do so, an application for appointment of an expert witness has to be submitted. The opinion of an expert commissioned by a tenant is treated as a private opinion of a party, rather than an objective analysis.

The above has to be supplemented by case law. In its judgement in case V CSK 467/1, the Polish Supreme Court emphasized that the general rule contained in article 354 § 2 of the CC requires the parties to cooperate during performance of an obligation, which means that in the case of defects in premises, the tenant should inform the landlord of the defect and request him to eliminate it. Later in the judgment, the Polish Supreme Court mitigates this requirement, by stating that the notification of the defect can take any form, including specific behavior. The above mentioned position is actually used by the courts, which consider article 682 CC in the context of past relations between the parties and all the circumstances of a particular case. Such an interpretation appears to take into account the importance of the powers granted to tenants and their implications on landlords. However, it is not shared by all the doctrine. There are opinions claiming that effective

termination of the lease does not require prior notification to a landlord. There are also a number of judgments issued prior to that of the Supreme Court mentioned above that interpret the provision differently. The judgement of the District Court of Wrocław, dated April 22, 2013 in case II Ca 1609/12 explicitly stated that "art. 682 CC refers to defects in premises, regardless of the time they arise and whether they can be removed and the tenant is not obliged to notify the landlord to remove the defect prior to the termination of the agreement".

These controversies do not occur if the defect cannot be removed. In such case, it is clear that the termination of the lease agreement is possible even without prior notification being given to the landlord and a claim for removal of the defect. It should also be noted that the possibility of using article 682 CC should be considered together with article 681 CC, which imposes an obligation on the tenant to pay minor expenses with respect to the leased premises. The tenant is entitled to terminate the lease agreement if it has previously complied with the obligation set forth in article 681 CC.

In conclusion, although article 682 CC gives tenants the right to claim defects in the premises to justify early termination of the lease agreement, each case must be considered in light of all the relevant circumstances, in particular the previous relations between the parties. Recent case law does not leave landlords unprotected against the potential abuse of the powers granted to tenants.

PUBLIC PROCUREMENT

Another special purpose act – the Transmission Infrastructure Act – comes into effect

The Act on the Preparation and Implementation of Transmission of Strategic Network, dated 22 July 2015 (the "**Act**"), came into effect on 15 September 2015.

Given that the Act regulates issues of material importance for the country's energy security, the legislator decided to apply special legal solutions that simplify the investment process procedures, as a result of which the Act has been labelled as a "special purpose act".

The solutions proposed in the Act have been introduced in order to ensure a stable legal framework encompassing the entire investment process involved in strategic transmission network projects, including those carried out using European Union budget funds.

The European Union has granted subsidies to finance the implementation of energy transmission network projects in connection with Poland's obligation to meet the requirements set out in Regulation (EU) No 347/2013 of the European Parliament and of the Council of 17 April 2013 (the "**Regulation**") concerning trans-European energy infrastructure. The purpose of the Regulation was, among other things, to accelerate the process of constructing energy networks of strategic importance and to enable the application of a fast track procedure to obtain decisions and permits necessary to carry out such projects.

The following undertakings are among transmission of strategic network investment projects:

- Strategic investment projects relating to the construction of the electricity interconnection Poland – Lithuania.
- Strategic investment projects necessary to increase the exchange capacity between the energy networks of Poland and its neighbouring countries.

- Strategic projects involving investment in the country's internal energy transmission networks necessary to introduce power from renewable energy sources, adopted in the development plan for the national transmission network.

In connection with the above, the Act introduces mechanisms aimed at accelerating the process of implementing strategic investment projects, involving, among other things, far-reaching measures facilitating the acquisition of real properties for this purpose.

The Act provides, for example, for the possibility of expropriating real properties against compensation in order to use them to construct energy networks. The amount of compensation will be negotiated between the investor and the owner of the real property on the basis of a valuation prepared by a valuer. If they do not reach an agreement, the price will be determined by the Voivode. It is important that owners who do not accept the proposed price will be able to assert their rights in court, though this will not affect works that are already underway. Decisions issued in the course of an investment process will be immediately enforceable and no appeal by any entity will prevent them from being carried out by the investors.

Similar solutions have also been adopted in other special purpose acts, such as the Road Act or the Railway Act.

At present, in accordance with the European Council's decision regarding the European Union's budget for the years 2014-2020, a financial contribution of EUR 82.5 billion has been granted to Poland from the cohesion policy budget, to finance, among other things, infrastructure projects.

In view of the above, a number of energy transmission infrastructure projects are likely to be carried out by 2025. There are plans to implement 30 such projects, with a total value of approximately PLN 4.5 billion.

TAX

Revolutionary changes in transfer pricing laws

During the last week in October, the President of the Republic of Poland signed a Law on changes to corporate income tax, personal income tax and certain other rules dated October 9, 2015 (the "**Law**") which introduces important amendments to transfer pricing regulations, as well as limited anti-tax-avoidance clause in the taxation of dividends.

Under the Law, fewer taxpayers will be subject to transfer pricing documentation requirements than is currently the case. However, the vast majority of the remaining entities will be subject to important new obligations, including the obligation to be in possession of and update a comparative analysis (i.e. benchmarking analysis) and submit to the tax office a simplified version of the transfer pricing documentation and, in some cases, reports on the income of subsidiaries or foreign branches (so-called country-by-country reporting).

The new documentation to be prepared will be of considerable scope and supplementary material will be required. Further, in the vast majority of cases, comparative analyses and additional documentation will also be required.

Once the changes to the legislation have been introduced, transactions carried out within a tax group (i.e. tax unity) will still not be covered by the rules on transfer pricing. Certain aspects of the Law are described below:

Who will be obliged to fulfill new obligations?

- In general, the obligation to prepare the documentation will be imposed on entities whose revenues or costs exceed 2 million euros per year.
- In the definition of related parties, the equity interest has been increased from 5% to 25% (the other criterion in the definition—i.e. control / management—has not been changed).
- There are new, dependent on taxpayer's turnover, limits for transactions which are required to be documented (basic limit amounts 50 000 euros).
- The list of events that must be documented has been extended: the changes include transactions that impact the income (loss) made by the taxpayer; e.g. cash pooling agreements, joint venture agreements.

What should be included in the documentation?

- Under the new regulations the purpose of the documentation is not only to describe the transactions, but also to prove that the intra-group transactions are arm's length.
- Taxpayers with income / expenses within the range of 2-10 million euros will be under the obligation to prepare i.a. a description of the transaction between related parties, including a description of functions, assets and risks involved, algorithm of fee calculation, analysis of financial data, realized business strategy and transfers of functions, risks or assets.
- Taxpayers with income / expenses within the range of 10-20 million euros will additionally be under the obligation to prepare an comparative analysis description (i.e. a benchmarking analysis) based (if possible) on data collected on Polish market.
- Taxpayers with income / expenses in excess of 20 million euros will also need to prepare information for the whole group (i.e. a master file).
- Regardless of the level of turnover, taxpayers with branches abroad, which are parent undertakings, or consolidate results, or are taxpayers with a consolidated revenue of over 750 million euros, will be under the obligation to submit to the tax office a report on the income of subsidiaries and/or branches (so-called "country-by-country reporting").

Timeframes for the preparation of the documentation

- Taxpayers with income / expenses exceeding 10 million euros shall be required to attach a summary report on transactions with related parties to their tax return.
- A deadline for the preparation of a substantial part of the documentation has been introduced: taxpayers will be required to file statements about the preparation of documentation for the year to which the tax return refers.
- The obligation is to update the comparative analysis (benchmarking analysis) at least once every three years.

Possible additional changes

- Additional draft changes to the regulations in the area of transfer pricing, among others, have been prepared by the political party which won the parliamentary elections (PIS). If the planned changes were to come into force, taxpayers would be obliged, among other requirements, to provide collective information on transactions with related parties up to January 25 of the year following the year in which the transactions were performed.

Changes in Corporate Income Tax legislation— the "anti-avoidance clause" in respect of dividends

- The new regulations also envisage the possibility of the tax authorities refusing to apply the tax exemption for dividends paid or received when there exist no sound economic reasons to support the alienation of shares in the company paying the dividends or other income exempted from taxation.

Steps to be taken

The majority of changes to the transfer pricing rules come into force on January 1, 2017, although some of the new reporting requirements will come into force in 2016. The changes may require:

- conducting a preliminary analysis / diagnosis on the impact of new legislation and steps to take to adapt to new regulations;

- performing benchmarking analysis to evidence compliance with the arm's length principle and / or potentially modifying the financial conditions of the transaction;

- preparing the new, compulsory documentation.

The anti-avoidance clause in respect of dividends will be effective as from January 1, 2016 and may require the restructuring of the holding structures, especially with respect to situations where the holding structures were shaped only for the purpose of tax savings.

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