

**REPORT OF THE MANAGEMENT BOARD OF LPP SA
ON TAX RISK EVALUATION
FOR THE FINANCIAL YEAR 1.02.2022 - 31.01.2023**

From 1 February 2022 to 31 January 2023, the Company identified tax risks described in the enclosed "2022 Tax Risk Register".

In terms of occurrence of any prospective tax risks for the Company, the following issues have been analysed in detail.

I. Consequences of the entry into force of a legislative package involving CIT, referred to as "Polish Deal"

(A) "Hidden dividend"

In line with the Polish Deal, provisions of law on a hidden dividend were introduced to enter in force from 2023. However, the said provisions resulted in numerous doubts arising, in particular, from: (i) major construing problems concerning the relation between the hidden dividend provisions and transfer pricing as well as (ii) excessively broad inclusion of prerequisites for classifying costs as hidden dividend (cases were possible in which the provision imposing the taxation of benefits as the so-called "hidden dividend" would apply to economically justified transactions, the main purpose of which was not the transfer of financial surpluses to associates). The said threats were pointed out by branch-specific organisations, which also gave recognition to the need to limit anti-abuse provisions that could apply to similar categories of payments (the same categories of payments could be affected by, among others, the provisions governing the hidden dividend, the pass-through income tax and the minimum tax).

In consequence, the amendments did not enter into force, i.e., the laws adopted were repealed before their entry into force.

(B) Minimum income tax

Effective as of 1 January 2022, in the Corporate Income Tax of 15 February 1992 (consolidated text: Journal of Laws of 2022, item 2587, as amended), the legislative authority introduced provisions on the minimum income tax (Article 24ca). Subsequently, the application of the said provisions on the minimum income tax was suspended for the period from 1 January 2022 to 31 December 2022, with the said suspension being prolonged for the following year (by 31 December 2023, i.e. the provisions in question will apply to revenue generated as of 1 December 2024).

Simultaneously with the prolonged suspension of the provisions, the regulations were modified, in particular, as follows: (i) increase to 2% of the profitability ratio, with a simultaneous change of the calculation methodology (among others, exclusion of charges under PPE lease contracts from tax deductible costs, exclusion from revenue of

trade receivables transferred to entities from the factoring industry, exclusion of the value of the excise duty), (ii) introduction of an alternative method for determining the taxable basis – as chosen by the taxpayer (the taxable basis is 4% of revenue (tax rate of 10%) or it constitutes 2% of revenue + passive costs, i.e. debt financing and intangible services + disclosure of intangible assets (tax rate of 10%), (iii) expanded catalogue of tax exclusions (municipal companies, small taxpayers, taxpayers generating the majority of revenue in connection with performance of health care activities, taxpayers with profitability in one of the last three tax years exceeding 2%, and taxpayers in bankruptcy or liquidation).

As mentioned above, ultimately, the said provisions did not apply in the tax year 1.02.2022 – 31.01.2023.

(C) **Pass-through income tax**

From 1 January 2022, CIT payers incurring outlays for foreign associates have been burdened with an additional tax due, i.e. the pass-through income tax. From the start, these provisions gave rise to many doubts. Thus, in the legislative package called Polish Deal 3.0, these provisions were updated and they entered into force in their new wording as of 1 January 2023. These provisions govern income generated in the tax year commencing after 31 December 2022.

The updated provisions concern the following: (i) the pass-through tax becomes levied solely on costs recognised as tax deductible costs, (ii) specifying in detail that the associate for the benefit of which costs are incurred has neither a registered office nor a management board in the territory of the Republic of Poland, (iii) specifying in detail the condition concerning 50% of revenue generated by an associate and the condition involving the transfer of revenue to another entity (at least 10%), (iv) simplified condition for preferential taxation in the country of the registered office, the management board, registration or location of an associate (the condition for lower taxation is to apply directly to the associate's revenue generated from a specific receivable and not the overall operations or income of such associate), (v) adequate application of the pass-through tax provisions to specific schemes involving tax transparent companies or foreign entities transferring revenue to other foreign entities benefitting from low taxation.

As stems from the analyses carried out, the amendments to the pass-through tax provisions will not affect the tax settlements of LPP SA.

(D) **CFC**

As part of the amendments to Polish Deal 3.0, there were changes implemented in the taxation of income of CFCs. The provisions governing taxation of owners of CFCs were implemented to the Polish legal system in 2015. Subsequently, they were updated in 2018 to adjust them to the Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market (Official Journal EU of 2016, L 193, p. 1; as last amended, Official Journal EU of 2017, L 144, p. 1; the so-called ATAD directive) and at the beginning of 2022 to tighten the Polish tax system as part of the thorough reform having the form of the Polish Deal.

The concept of CFC taxation has been designed to prevent Polish tax residents from taking advantage of structures involving entities from tax havens or countries making extensive use of tax exemptions or imposing low taxes. In specific cases, a Polish tax resident is required to report, for taxation purposes, income in Poland actually earned by a foreign entity with which the resident is associated.

According to the legislative authority, the amendments implemented as of 1 January 2023 were aimed at eliminating double or multiple taxation of CFCs in the event of cascading dividends in holding structures. As part of these amendments, the definition of subsidiary has been clarified, as well as the prerequisite of high profitability of a foreign entity in relation to assets held in the event of a prospective transfer of assets during the year.

In practice, however, the effect of the amendments is to prevent recognition of dividends received by a CFC as exempt from tax, even in the event of fulfilment of conditions for the participation exemption provided for in the EU Directive or the CIT Act. The above would result in the double taxation of single income. The absence of an exemption for dividends received by a CFC in which a dividend is paid by the operative company and, subsequently, paid upwards in the structure, could result in CFC taxation at each level. Therefore, on the part of the Polish taxpayer, the same dividend is taxed multiple times as each company in the holding structure (other than the operative one) will be treated by a Polish taxpayer as CFC.

Considering the current cash flow structure in the LPP SA Group, the amended provisions will not affect the settlements of LPP SA.

(E) Taxpayer's declarations for WHT purposes

As of 1 January 2022, in the CIT Act, there were new provisions implemented, involving new rules for WHT collection. According to the said provisions, if passive payments (i.e. interest, licence fees, dividends) charged with WHT and made to associates exceed PLN 2 mln to a single entity annually, then Polish payers disbursing remunerations are, as a rule, required to collect WHT at a basic rate without recognising any reduced rate or exemption. If the said threshold is exceeded, a WHT exemption or reduced WHT rate may still be applied, yet it requires one of the following options to be applied: (i) obtaining an opinion confirming tax preferences, (ii) application of the pay-and-refund mechanism or (iii) submission of a WH-OSC statement.

In practice, numerous doubts have arisen in respect of the use of WH-OSC statements. Amended provisions prolonged the validity of the "basic" statement made by the payer for pay-and-refund purposes by the last day of a given tax year, with a postponement (by the last day of the month following the end of the tax year) of the deadline for submitting the "closing" statement.

The benefit arising from the above-mentioned amendment is the prolongation of the validity of the basic statement and the postponement of the deadline for submitting the "closing" statement enabling the waiver of the obligation to apply the pay-and-refund mechanism.

At present, the amendment does not affect LPP SA, yet it may have a bearing on the Company in the future as LPP SA pays benefits subject to the obligation to collect WHT e.g. dividends and licence fees.

(F) Settlement of debt financing costs in tax costs

From the beginning of 2022, in the catalogue of non-deductible costs, the CIT Act includes the costs of debt financing obtained from an associate and allocated to equity transactions. This restriction applies, first of all, to intra-group financing.

The amendments introduced include a clarification of the amount to be excluded from tax costs, i.e. a higher amount is to be excluded (PLN 3,000,000; 30% of EBITDA). The provisions governing the costs of debt financing for equity transactions have also been amended. The amendment excludes the application of the above-mentioned provisions in cases where the financing party is a bank or a cooperative savings and credit union with its registered office in an EU Member State or an EEA state. Additionally, the said provisions would not apply to debt financing granted for the acquisition of, or subscription to, shares (stocks) or overall rights and duties in entities unrelated to the taxpayer.

At present, the said amendment does not affect the tax settlements of LPP SA. It would apply in the event of debt financing related to the acquisition of shares in non-associates.

(G) Documentation requirements concerning the so-called haven transactions

From the beginning of 2021, there were in force highly controversial provisions requiring Polish tax residents to verify their contracting parties and document, for transfer pricing purposes, the so-called indirect haven transactions.

In 2022, the following amendments were adopted:

- repeal of the documentation requirement for “indirect haven transactions”, i.e. transactions in which the beneficial owner of receivables is a tax haven resident, and
- increased documentation thresholds for “indirect” haven transactions – to PLN 2.5 mln for financial transactions and PLN 500 thousand for other transactions; the thresholds apply both to transactions executed with non-associates and associates.

In other words, the amendments result in the following: (i) more realistic materiality thresholds for direct and indirect haven transactions, which, if exceeded, give rise to a tax liability, by increasing them (for indirect haven transactions – a double value; for direct haven transactions – different thresholds for specific transaction types), (ii) the changed scope of the documentation requirement in indirect haven transactions, (iii) elimination of the presumption of residence of the beneficial owner in a tax haven (clarification that the provision applies to the beneficial owner of a receivable arising from a transaction, and cancellation of the presumption of residence of the beneficial owner in a tax haven, moving towards an exclusion of the documentation requirement in specific cases).

The said amendment affects the operations of LPP SA as it excludes requirements imposed on its tax and reporting departments. In the preceding period, the tax and IT departments jointly developed and implemented a mechanism for sending and receiving declarations from contracting parties, which currently has become groundless.

(H) Requirement to submit information on transactions with non-residents

Entities concluding agreements with non-residents within the meaning of the foreign exchange law are required to submit information on such transactions on an ORD-U form.

From 1 January 2022, taxpayers required to submit transfer pricing information (TPR-C) have been exempt from the duty to fill in and submit the ORD-U form in all instances specified in statutory law. However, the exemption does not apply to taxpayers and companies other than legal entities, effecting transactions with tax havens.

The said amendment affects LPP SA as it facilitates performance of tax reporting duties.

II. Effects of the entry into force of a VAT legislative package

(A) Choice of tax treatment of financial services

Basically, financial services are exempt from VAT. However, the Polish Deal introduced the possibility of their voluntary taxation. The updated provisions have given the possibility of choosing tax treatment for the said services, i.e. a waiver of exemptions referred to in Article 43(1)(7), Article 12 and Articles 38-41 of the VAT Act. If the waiver in question was applied, financial services would be charged with the basic VAT rate of 23%.

The implementation of the amendment having the form of the waived exemption have been and still is being considered by LPP SA in terms of the intra-group financing process.

(B) VAT groups

At the beginning of 2023, provisions on VAT groups came into force. This is a solution widely applied in many EU countries, which substantially facilitates settlements for entities being group members. In a VAT group, its members are exempt from VAT tax in transactions between group members.

A VAT group is an autonomous institution of the EU community law. Community provisions in the form of a directive (currently, Directive 2006/112/EC) provide for the possibility of the introduction by member countries of a VAT group institution.

The Polish legislative authority has incorporated the possibility of establishing a VAT group in the Polish Deal tax reform. Initially, regulations governing VAT groups were to become effective as of 1 July 2022 and provided for linking VAT groups with the institution of a tax capital group (TCG) operating under the CIT Act. Finally, the VAT group and its underlying concept was introduced to the Polish tax system at the beginning of 2023 autonomously. According to the solutions implemented in the VAT

Act, the obligation to act as VAT payer, not only on its own behalf but also on behalf of other group members, may be transferred to one of the entities in the group.

Simply speaking, the new provisions provide for the possibility for taxpayers to settle jointly within VAT groups. Furthermore, the establishment of a VAT group requires the existence of entities having financial, economic and organisational links, which will be registered as VAT payers.

The said amendment may have a future impact on LPP SA. The Company is in the process of the initial analysis of benefits and costs related to the implementation of the institution in question.

(C) JPK_V7M files

At the beginning of 2022, the legislative authority permitted a waiver of filing an active grievance motion when correcting the record-related part of the JPK_VAT file. The condition for the above is that VAT arrears should be paid immediately and, before the submission of the JPK_VAT correction, neither preparatory proceedings have been initiated nor it has been disclosed in pending proceedings that an incorrect JPK_VAT file was submitted.

Additionally, the legislative authority made amendments also in the JPK_VAT structure.

The said amendment affects the operations of LPP SA. Relevant changes have been implemented with the participation of the IT department and the JPK application supplier.

III. Consequences of Russia's aggression on Ukraine

(A) Sale of the Russian company

Following the full-scale aggression of the Russian Federation on Ukraine in February 2022, LPP SA suspended its operations on the Russian market and, subsequently, closed its business by selling its distribution company on that market.

In terms of CIT, the transaction involving the sale of the Russian company was treated as equity transaction (disclosed in this source of revenue). The sale transaction generated a tax loss. Considering the fact that, under the tax law, a capital loss may not be deducted from operating activities, the probability of recovering this loss in terms of tax is low.

The exclusion of the transaction from operating activities resulted in the increase of tax revenue and, consequently, CIT.

Figures taken into account in the CIT calculation:

TAX RESULT	
REVENUE	600,799,475.23
COSTS	912,992,712.76

LOSS	-312,193,237.53
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(B) Operations in Ukraine

Due to the aggression of the Russian forces on Ukraine, LPP SA suspended temporarily its operations and supplies in that country. Trading activities were gradually being resumed in Ukraine, in the territory not inflicted by direct war operations. The reopening of traditional stores and the online store required a new approach to documentation received. There was a temporary problem with the receipt of communications from abroad, required to confirm the 0% VAT rate in the exports of goods. The above caused periodical problems with declaring VAT by the Company. After some time, those problems were solved by customs authorities.

IV. Public aid

In the period in question, LPP Logistics sp. z o.o., a single-member subsidiary of LPP SA, started benefitting from public aid in the form of an exemption from CIT of income covered by the aid-related decision.

The calculation and constant verification of the terms and conditions for public aid are complex. The degree of complexity is increased due to the fact that LPP Logistics sp. z o.o. conducts not only operations covered by the aid-related decision but it also pursues activities in many other areas.

These operations affect the activity of the LPP SA Group. The tax department cooperates with KPMG in terms of verification of the correctness of settlements.

V. Establishment of logistics companies in Romania and Slovakia

Logistics operations including, in particular, the handling of foreign warehouses, brought about a decision on establishing relevant special purpose vehicles in Romania and Slovakia.

The Company carried out intense analyses and works aimed at determining whether the activity in question is equivalent with having a permanent establishment in the above-mentioned countries within the meaning of the CIT laws and the permanent place of business within the meaning of the VAT laws. The analyses covered also the correct reporting and comprehension of transactions between LPP SA and LPP Logistics sp. z o.o. in the territory of Poland, with due consideration of transactions effected by subsidiaries in Romania and Slovakia. In that respect, the tax department co-operated with KPMG.

The works were aimed at determining the ownership of a permanent establishment under the CIT laws and the permanent place of business under the VAT laws. The co-operation included also the safeguarding of LPP Logistics in the territory of Poland in terms of transactions carried out by the branch.

VI. Intra-group financing

In the second half of 2022, the Company started implementing a new intra-group financing structure. The intra-group financing is aimed at ensuring the correct allocation of funds generated by the Group and, in particular, at preventing their unproductive retention in distribution companies. The said process has been based on intra-group loans, i.e. loans extended through subsidiaries to LPP SA as parent company and, if need be, vice versa.

The finance, reporting, tax and legal departments were specifically engaged in the analysis and the preparation of the processes in question. The Company co-operated in that respect with KPMG which developed a relevant tax approach for the purposes of the Group, involving WHT, VAT and CIT.

VII. National E-Invoice System

In 2022, the Company commenced preparatory works to implement the National E-Invoice System (NEIS), i.e. a mandatory public platform for issuing and receiving electronic invoices. Undoubtedly, the process of adjusting to those regulations will require numerous procedural and technical changes. It should be noted that, due to pending legislative works, their detailed scope may not be yet determined.

So far, the legislative authority decided to postpone the entry into force of the provisions governing the structured invoice by 1 July 2024. Therefore, the IT department decided that technical works aimed at implementing the provisions in question would start in the second quarter of 2023. The Company delayed the works also due to amendments announced by the Ministry of Finance, involving, among others, no transmission of consumer invoices (B2C) to the NEIS.

In the period in question, the analysis involving the NEIS draft covered, among others, the following issues:

- prolonged possibility of issuing an invoice from cash registers and simplified invoices in the current form by 31 December 2024,
- announcing that, in case of a break-down on the taxpayer's part, it will be possible to issue invoices offline, outside the NEIS, and send an invoice to the NEIS the day after its offline issuance,
- liberalisation of sanctions and announcing their application as late as starting from 1 January 2025
- changes in the e-invoice logical structure (there is still no final version, the works of the Ministry of Finance are in progress).

Based on the information from the Manager of the Tax Department, the Chief Accountant and the Manager of the Settlements Department, the Management Board acknowledges that the risks specified in section 4 of the document titled "Tax Risk Management" have not occurred. Furthermore, the Management Board acknowledges that the evaluation provided for in section

4 of "Tax Risk Management" in terms of the risk of occurrence of a given tax event is correct and, therefore, there is no need to re-evaluate the occurrence of specific risks.

Enclosure:

1) 2022 Tax Risk Register

Drawn up in Gdańsk on 29 May 2023.

Management Board of LPP SA:

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