

## 3.1 Income tax

### Accounting policy applied

The income tax of the reporting period includes current and deferred income tax. The current tax burden is calculated on the basis of the tax result for the given reporting period. The tax result differs from the accounting gross profit due to exclusion of revenue which temporarily is not subject to taxation, expenses which temporarily do not represent tax deductible revenue and those expenses and revenue that will not be subject to taxation. Tax burden is calculated based on the tax rates applicable in the given financial year.

Deferred income tax is recognized with respect to temporary differences between the tax base of an asset or liability and the corresponding carrying amount. Deferred tax liabilities are recognized with respect to positive temporary differences. Deferred tax assets are recognized with reference to negative temporary differences up to the amount of the Company's likely future taxable income sufficient to settle such temporary differences. The value of the deferred tax assets is reviewed at each balance sheet date in terms of prospects of generation of future tax profits required to settle it.

Deferred income tax assets and liabilities are subject to set-off in the case of existence of an enforceable legal title to set off deferred tax assets against deferred tax liabilities, and provided that such deferred tax assets and liabilities pertain to income tax charged by the same tax authorities if it is intended to settle the balances in net amounts.

### The Tax Group

On 29 September 2016, the companies of the PKP CARGO Group signed an agreement on the establishment of a tax group (hereinafter referred to as the "Tax Group") for the period of three fiscal years starting from 1 January 2017. The Tax Group consists of:

- PKP CARGO S.A. – as the company representing the Tax Group;
- PKP CARGO SERVICE Sp. z o.o.;
- PKP CARGOTABOR Sp. z o.o.;
- PKP CARGOTABOR USŁUGI Sp. z o.o.;
- PKP CARGO Centrum Logistyczne Małaszewicze Sp. z o.o.;
- PKP CARGO Centrum Logistyczne Medyka-Żurawica Sp. z o.o.;
- PKP CARGO CONNECT Sp. z o.o.

PKP CARGO S.A. is the parent of the Tax Group and represents the Tax Group with respect to the obligations provided for in the CIT Act and the Tax Ordinance Act.

In accordance with the CIT Act, the tax groups are treated as separate CIT payers. Thus, the companies of the Tax Group lose their separate identity for the purposes of CIT for the benefit of the Tax Group as a whole. The taxable income of the Tax Group shall consist of the Tax Group total income calculated as surplus of the total amount of income of all companies of the Tax Group over the sum of their losses. The individual identity of the Tax Group pertains solely to corporate income tax, and should not be understood as tantamount to a separate legal identity. Also, it does not affect the payment of any other taxes.

The companies of the Tax Group must meet a number of requirements such as, *inter alia*, appropriate value of equity, share of the Tax Group representative in equities of the Tax Group companies, lack of tax arrears, achieving specific level of profitability and execution of transactions with companies out of the Tax Group on an arm's length basis only. Any breach of the above requirements shall entail dissolution of the tax group and loss of its tax payer status. As at 31 December 2018, the Tax Group satisfied the above requirements.



### SIGNIFICANT VALUES BASED ON PROFESSIONAL JUDGMENT AND ESTIMATES

The Group recognizes deferred tax assets assuming that the future taxable income will enable utilization of such deferred tax assets. According to the long-term financial forecasts developed by the Group, these assets are not impaired as at the balance sheet date. A future deterioration of the tax results might lead to this assumption becoming unfounded.

### Income tax recognized in profit / loss

	2018	2017
<b>Current income tax</b>		
Current tax liability	(70.0)	(58.2)

	2018	2017
Adjustments posted in the current year relating to tax from previous years	(1.6)	(0.1)
<b>Deferred tax</b>		
Deferred income tax of the reporting period	11.7	23.5
<b>Income tax recognized in profit / loss</b>	<b>(59.9)</b>	<b>(34.8)</b>

According to the legal provisions in effect, no differentiation of rates is expected in the future periods. Frequent differences of opinions as to legal interpretation of the tax regulations, both within the State bodies, and between the State bodies and enterprises, entail lack of certainty and give rise to conflicts. Therefore, the tax risk in Poland is much higher than usually observed in the countries with better developed tax systems. Tax returns may be subject to control for a period of five years, starting from the end of the year of the tax payment. As a result of such controls, the Group's tax settlements may be increased by additional tax liabilities.

#### **Deferred income tax recognized in other comprehensive income**

	2018	2017
Deferred tax on the measurement of hedging instruments	4.4	(5.3)
Deferred tax on actuarial earnings / (losses) pertaining to employee benefits	2.5	7.0
FX differences from translation of the balance of deferred income tax recognized in other comprehensive income	(2.4)	0.3
<b>Deferred income tax recognized in other comprehensive income</b>	<b>4.5</b>	<b>2.0</b>

#### **Reconciliation of the effective tax rate**

	2018	2017
<b>Profit before tax</b>	<b>243.8</b>	<b>116.5</b>
Income tax expense at 19%	(46.3)	(22.1)
<b>Tax effect of revenue which does not constitute revenue within the meaning of tax regulations, including:</b>		
Reversal of non-tax provisions and impairment losses	0.4	0.4
Valuation under the equity method	0.7	0.2
Valuation of the liabilities arising out put option	-	0.9
Recovered VAT	1.7	0.8
Other	0.6	0.5
<b>Tax effect of non-deductible expenses arising from tax regulations, including:</b>		
PFRON disability fund	(4.8)	(4.4)
Establishment of non-tax provisions and impairment losses	(0.2)	(1.4)
Permanent differences in expenses related with property, plant and equipment	(5.4)	(3.3)
Representation expenses	(0.9)	(0.8)
Penalties and compensations	(1.2)	(1.0)
Value added tax and other public law liabilities	(1.1)	(1.8)
IT expenses above the limit	(2.3)	-
Other	(3.3)	(1.3)
<b>Effect of tax losses used in a period in which deferred tax was not recognized</b>	<b>3.6</b>	<b>-</b>

	2018	2017
<b>Effect of the establishment/(reversal) of a deferred tax asset charge on tax losses</b>	(0.9)	(1.1)
<b>Effect of application of various tax rates</b>	(0.1)	(0.3)
<b>Adjustments disclosed in the current year with reference to past years' tax</b>	(0.4)	(0.1)
<b>Income tax recognized in profit / loss</b>	(59.9)	(34.8)
<b>Effective tax rate</b>	24.6%	29.9%

The corporate income tax rate effective in Poland in the years 2017 - 2018 amounted to 19%. In the case of the AWT Group companies, the relevant tax rates were as follows: 19% in the Czech Republic and 10% in Hungary.

### Balance of deferred tax assets and liabilities

Deferred tax assets and liabilities are offset at the level of the financial statements of each Group company. Accordingly, the following values are presented in these Consolidated Financial Statements:

	31/12/2018	31/12/2017
Deferred tax assets	135.6	137.7
Deferred tax liabilities	(88.5)	(107.4)
<b>Total</b>	<b>47.1</b>	<b>30.3</b>

### Movements in deferred tax before the set-off

2018	31/12/2017 (audited)	Corrections of prior period error and effect of the implementation of IFRS 9	1/01/2018 (restated)	Recognized in profit or loss	Recognized in other comprehensive income	FX differences resulting from translation of deferred tax balance	31/12/2018
<b>Temporary differences relating to deferred tax (liabilities) / assets:</b>							
Non-financial non- current assets	(144.1)	-	(144.1)	13.4	-	(2.7)	(133.4)
Other provisions and liabilities	9.5	-	9.5	1.2	-	0.1	10.8
Inventories	(1.9)	-	(1.9)	(2.2)	-	-	(4.1)
Trade receivables	4.1	0.6	4.7	(1.1)	-	-	3.6
Provisions for employee benefits	125.7	4.1	129.8	1.6	2.5	0.1	134.0
Other	(4.3)	-	(4.3)	0.2	4.4	-	0.3
Unused tax losses	37.2	-	37.2	(1.4)	-	0.1	35.9
<b>Total</b>	<b>26.2</b>	<b>4.7</b>	<b>30.9</b>	<b>11.7</b>	<b>6.9</b>	<b>(2.4)</b>	<b>47.1</b>

As at 31 December 2018, deferred tax assets on account of tax losses for use in future periods represented loss of the Parent Company in the amount of PLN 139.7 million and of the subsidiaries in the amount of PLN 48.4 million. It will be possible to deduct tax losses in the amount of PLN 167.1 million within five fiscal years following the end of operation of the Tax Group. Other tax losses may be deducted within five fiscal years following the establishment of the Tax Group. According to the Parent Company Management Board, the risk as at 31 December 2018 that it will be impossible to realize the above assets is low.

2017	1/01/2017 (audited)	Corrections of prior period error	1/01/2017 (restated)	Recognized in profit or loss	Recognized in other comprehensive income	FX differences resulting from translation of deferred tax balance	31/12/2017
<b>Temporary differences relating to deferred tax (liabilities) / assets:</b>							
Non-financial non- current assets	(183.0)	-	(183.0)	38.6	-	0.3	(144.1)
Other provisions and liabilities	17.4	-	17.4	(7.9)	-	-	9.5
Inventories	0.9	-	0.9	(2.8)	-	-	(1.9)
Trade receivables	3.8	-	3.8	0.3	-	-	4.1
Provisions for employee benefits	118.5	3.9	122.4	0.4	7.0	-	129.8
Other	2.5	-	2.5	(1.5)	(5.3)	-	(4.3)
Unused tax losses	40.8	-	40.8	(3.6)	-	-	37.2
<b>Total</b>	<b>0.9</b>	<b>3.9</b>	<b>4.8</b>	<b>23.5</b>	<b>1.7</b>	<b>0.3</b>	<b>30.3</b>

#### **Tax loss not recognized in calculation of deferred tax assets**

The amount of tax losses not included in the calculation of deferred tax asset results from tax losses generated by the following companies:

	31/12/2018	31/12/2017
AWT CE s.r.o.	20.2	59.1
AWT a.s.	-	27.4
AWT Rail HU Zrt.	22.1	17.9
AWT Cechofracht a.s.	9.2	-
PKP CARGOTABOR USŁUGI Sp. z o.o.	7.5	7.5
CARGOSPED Terminal Braniewo Sp. z o.o.	1.6	1.6
<b>Total</b>	<b>60.6</b>	<b>113.5</b>

In the financial year ended 31 December 2018, in connection with the registration of a change in the registered office of AWT CE s.r.o., the company lost the possibility of settling tax losses in the amount of PLN 43.2 million.

Expiration dates of the tax losses to which deferred tax assets were not applied as at 31 December 2018

Year	2019	2020	2021	2022	2023	2024 and later on	Total
Unused tax losses	5.5	7.9	15.1	13.1	9.1	9.9	60.6

Expiration dates of the tax losses to which deferred tax assets were not applied as at 31 December 2017

Year	2018	2019	2020	2021	2022	2023 and later on	Total
Unused tax losses	2.2	20.9	19.9	36.7	12.5	21.3	113.5