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FREEDOM OF ECONOMIC ACTIVITY AND TAX STATUS OF A COMMUNE

*Michał Koralewski**

Abstract

This article is about permissible economic activity of a commune with special emphasis on the principles of taxation of individual actions taken by such a body. The basic thesis of this study is that recognition of a commune as the payer of goods and services tax is possible only to the extent of activities it undertakes within the scope of dominium, not imperium. The confirmation of that thesis is sought in historical and axiological considerations about economic freedom and also the analysis of legal framework for the activity of a commune. Moreover, the article provides an overview of practical problems related to taxation of communes.

* PhD student at the Faculty of Law and Administration, University of Gdańsk, e-mail: michal@koralewski.pl

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Introduction

The principles of conducting economic activity by public sector entities have evolved over the centuries, undergoing sometimes even revolutionary changes, starting from the era of state monopolies, where the ownership of land and means of production was concentrated in the hands of the sovereign, through the gradual admission of private activity, to the clear separation of the activity of public entities in the spheres of *imperium* and *dominium*. I shall explore the hypothesis, according to which recognition of a commune as the payer of tax on goods and services is possible only to the extent of activities it undertakes within the scope of *dominium*. Therefore, the purpose of this article is to resolve doubts emerging so far as to the tax status of a commune with regard to tax on goods and services. This issue is of practical importance due to the broad list of activities undertaken by a commune. The demonstration of the adopted thesis shall allow for the proper classification of activities of a commune in the light of tax on goods and services.

The paper uses the historical method in order to show the evolution of understanding of the concept of “economic freedom” as well as the role of the state in the economy. The study also uses the comparative method of changing political and legal doctrines in this respect. In addition, a descriptive method is used in order to show the current legal status and practical problems in its application.

This distinction of actions taken by the state and local government units with respect to the governing activities and civil law relations cannot remain without effect on their tax consequences, particularly with regard to the goods and services tax [VAT].

This paper shall discuss the scope of permissible economic activity of a basic unit of administrative division, i.e. a commune, with special emphasis on the principles of taxation of individual actions taken within the scope of *imperium* or *dominium*. In the first place, however, the concept of economic freedom and its boundaries as well as two spheres of activity of public entities require to be defined.

Freedom of rights or the right to freedom

There is no other word that would be given more different meanings, and that would in so many ways appeal to people more than the word 'freedom'. Being, however, a key value, this concept needs to be further specified, although from all the world's imprecise concepts, 'freedom' lacks precision to the highest degree possible (E. Burke)¹.

On the one hand, positive liberty is the opportunity to do what one should want to do, without being constrained to do what one should not want to do (Montesquieu)². On the other hand, it is an imperative of such conduct so that free use of the lawlessness of one man could coexist with the liberty of anyone else. Therefore, the right to freedom defining the social standards requires that no one's freedom should be limited, as long as this standard is not restricting the freedom of another individual³.

The concept of economic freedom, which has grown on the basis of natural law assumptions of the inherent and unrestricted freedom of an individual, appears for the first time in a philosophical thought together with the 17th and 18th century liberal thought which believes it to be – next to the individual liberty and private property – a pillar of the natural social order in the state⁴. However, unrestrained, almost absolute economic freedom favouring the state nihilism and utilitarian approach to the role of an individual in the society led to the formation of numerous pathologies of the economic system that the state – as a "night watchman" – was not able to cope with since internally disordered freedom is not freedom, but nihilism⁵.

The twentieth-century evolution of an economic thought, seeing flaws of the extreme liberalism, soothes its face leaving economic freedom a philosophical and legal pillar of the economic system of the free market economy. A market econ-

¹ B. Szlachta, *Władza, wolność, prawo. Wybór tekstów z historii doktryn politycznych dla studiujących prawo, nauki polityczne i filozofię*, Kraków 1994, p. 148.

² *Ibidem*, p. 139.

³ A. Kość, *Podstawy filozofii prawa*, Lublin 2005, pp. 156–161.

⁴ R. Biskup, *Wolność gospodarcza w wymiarze podmiotowym*, Lublin 2011, p. 106.

⁵ M. Zdyb, *Działalność gospodarcza i publiczne prawo gospodarcze*, Kraków 2001, p. 39.

omy is a free economy under which the possibility of taking up and pursuing economic activity by any entity is ensured and guaranteed⁶.

However, since source freedom of an individual underlying economic freedom is experiencing restrictions, it is not possible not to put boundaries to economic freedom also derived therefrom⁷. It has its roots in the natural law principles of human dignity. Organisational units, however, which are also involved in economic circulation lack such attribute. Depriving these units the possibility of exercising economic freedom would undermine economic freedom that man is entitled to. One of the aspects of economic freedom is its exercising as well as determination of the legal form in which the economic activity shall be conducted. None of the legal persons or other organisational units shall be established without the interference of man exercising in this respect his own economic freedom⁸.

To sum up this part of the discussion, two basic conclusions drawn therefrom have to be pointed out. The first, is the fact that economic freedom is not an unlimited absolute and may be subject to restrictions. The second states that a derivative of a man's economic freedom is the ability to pursue economic activity by organisational structures that he established.

While in the first case it is legitimate to use the word 'freedom', the scope of which may, at the most, be subject to restrictions, however in case of organisational units their economic freedom is a right granted to them the boundaries of which are defined by respective legal instruments. In other words, the first situation may be described by the phrase: "everything which is not expressly forbidden is allowed", while the other: "everything which is explicitly defined is allowed".

Imperium and dominium

The determination of limits of freedom of economic activity is particularly important in cases where certain entities active in the market are entitled to a special position, which manifests itself in having the powers to specify the legal situation of other participants of economic circulation, including their contractors. This includes, of course, public entities equipped with specific administrative power.

⁶ H. Gronkiewicz-Waltz, Krzysztof Jaroszyński, *Europeizacja publicznego prawa gospodarczego*, Warszawa 2011, p. 81.

⁷ R. Biskup, *Wolność...*, p. 164.

⁸ See M. Zdyb, *Działalność...*, pp. 124–131.

The reconciliation of the idea of economic freedom, which inherent feature is the equality of market actors, with joining the state and local government units to the economic circulation required the separation of the administrative power of public entities from cases of their entering into partnerships. This aim was achieved by separating the spheres of *imperium* and *dominium*.

The first of them is primarily characterised by a dominant element of power, and also a separate system of protection of rights of subordinate entities and the limited role of courts. Secondly, within this sphere of activity, the state and local government units derive from constitutional law, constitutional and basic acts as well as regulations and authorisation to interfere with the sphere of rights of citizens, including the sphere of property rights, at the same time excluding civil law standards. The fundamental difference of sources of the law governing the functions of the state in terms of *imperium* and *dominium*, another way of protecting entities engaged in legal relations with the state in both spheres of its activity, differentiated objectives of the indicated spheres as well as the need to respect the limits of competencies resulting from the separation of powers do not allow to freely use civil law institutions in the sphere of activity of the state specified as *imperium*⁹. For these reasons, this sphere is called the public or administrative power.

The actions of public entities acting as equal economic operators on the basis of civil law relations are usually referred to as *dominium*. This is the so-called ownership sphere in which the state and local government units are owners or buyers of goods or services being the subject of trade.

Legal framework for the activity of a commune

The principles discussed above are fully reflected in the law provisions. The principle of economic freedom is contained in Art. 20 of the Constitution of the Republic of Poland, which makes it one of the constitutional foundations of the state's social market economy. Whereas, the permitted scope of limitations of constitutional rights and freedom results from the subsequent articles of the Constitution of the Republic of Poland (Art. 22 and Art. 31 para. 3). According to these articles, they may be "imposed only by statute, and only when necessary in a democratic state for the protection of its security or public order, or the protection of the natu-

⁹ See the justification of the resolution of the full composition of the Civil Chamber of the Supreme Court of 26 October 2007, ref. no. III CZP 30/07.

ral environment, health or public morals, or the freedoms and rights of other persons. These limitations cannot violate the essence of freedom and rights”.

Another article of the Constitution of the Republic of Poland which is important from the point of view of this study is the provision of Art. 7 which states that “the organs of public authority shall function on the basis of, and within the limits of, the law”.

Thus, the constitutional law confirms that economic freedom, although it is the principle that may be subject to limitations. Furthermore, it results from the provisions that any activity of public entities should be provided for in concrete legal standards (the principle of legalism). The last of the rules has been repeated in many other acts, both of general and constitutional importance. Examples of acts falling into the first category are: the Code of Administrative Procedure¹⁰ (see Art. 6) and the Tax Ordinance¹¹ (see Art. 120). The second group includes, among others, the Act on Communal Local Government¹² (see Art. 85).

Economic activity of a commune

First of all, a general remark should be made when transferring the above observations onto the allowed by the law economic activity of local government units. Namely, each of the three types of local government units is authorised to pursue economic activity in a different scope, the basis of which has been specified in relevant constitutional acts.

The provisions of Art. 13 of the Act on Provincial Local Government¹³ stipulate that the provinces may, in the sphere of public service, form limited liability companies, joint-stock companies or cooperatives, and it may enter into such companies or cooperatives. In contrast, outside this sphere, it may establish limited liability companies and joint-stock companies, and enter into them if the operations

¹⁰ The Act of 14 June 1960 – the Code of Administrative Procedure, consolidated text: Dziennik Ustaw of 2013, item 267.

¹¹ The Act of 29 August 1997 – the Tax Ordinance, consolidated text: Dziennik Ustaw of 2012, item 749.

¹² The Act on Communal Local Government of 8 March 1990, consolidated text: Dziennik Ustaw of 2013, item 594.

¹³ The Act on Provincial Local Government of 5 June 1998, consolidated text: Dziennik Ustaw of 2013, item 596.

of the company involve the performance of promotional, educational and publishing actions as well as the performance of telecommunications activities for the development of the province.

Whereas a district cannot conduct economic activity outside public service tasks, which stems directly from the provision of Art. 6 para 2 of the Act on District Local Government¹⁴.

In comparison to other local government units, the commune is seen as an entity authorised to pursue economic activity to the fullest extent. In accordance with the provision of Art. 9 para 2 of the Act on Communal Local Government, the commune and other communal legal persons may conduct economic activity outside public service tasks, but only in the cases specified in a separate act. However, the legal act to which the quoted provision refers to is the act on communal economy¹⁵. It sets out in the provisions of Arts. 2, 9 and 10 all permitted forms of economic activity which local government units may conduct. In addition, with respect to the commune, the act specifies cases in which it is possible to go beyond the sphere of public service. Importantly, the act does not directly indicate the areas in which this activity may be conducted – as is done, for example, by the Act on Provincial Local Government. In this case, only prerequisites the fulfilment of which makes such activity legal were mentioned (see Art. 10 paras. 1–3 of the Act).

Another question arises on the basis of the aforementioned. This time, a question about the way of separation of the activity falling into the sphere of public service from the one that goes beyond it. The provision of Art. 9 para. 4 of the Act on Communal Local Government may prove helpful in this regard. It stipulates that public service tasks, within the meaning of the Act, are the commune's own tasks, as defined in Art. 7 para. 1 of this Act the purpose of which is an ongoing and uninterrupted satisfaction of the collective needs of the population by way of provision of universally available services.

This does not mean, however, that taking up the fulfilment of public service tasks by the commune does not constitute carrying out the economic activity. Regardless of whether a local government unit is conducting its own actions or perform-

¹⁴ The Act on Provincial Local Government of 5 June 1998, consolidated text: Dziennik Ustaw of 2013, item 595.

¹⁵ The Act on Communal Economy of 20 December 1996, consolidated text: Dziennik Ustaw of 2011, No. 45, item 236.

ing commercial services, stating whether such actions may be classified as manifestations of the economic activity requires their comparison with the definition of economic activity as defined in Art. 2 of the Act on Freedom of Economic Activity¹⁶. If therefore actions undertaken by the commune take the form of gainful manufacturing, construction, trade and service activity or prospecting, exploration and extraction of minerals from deposits carried out on an organised and continuing basis¹⁷, they shall constitute the form of pursuing economic activity.

To sum up this part of the analysis, it should be pointed out that the concept of the economic activity of a commune should be understood as any form of its activity, both in the sphere of public service and beyond it, as long as it is pursued on an organised and continuing basis and is focused on profit-making.

Goods and services tax

In accordance with the provisions of Art. 15 paras. 1, 2 and 6 of the Act on Goods and Services Tax¹⁸, VAT taxpayers are natural or legal persons as well as organisational entities without legal personality carrying out economic activity regardless of the aim or result of that activity. Economic activity covers all actions of producers, traders or service providers, including entities obtaining natural resources and farmers as well as actions of self-employed professionals. The exploitation of tangible or intangible goods or assets for the purposes of obtaining income on a continuing basis is regarded as an economic activity. At the same time, public authorities and offices providing service for such authorities within the scope of implemented tasks imposed by separate law provisions, for the implementation of which they were provided for, excluding actions performed under civil law agreements, are not treated as taxpayers. Art. 13 para. 1 of the Directive 2006/112/EC of 28 November 2006 on the common system of value added tax¹⁹, which replaced the VI Directive, stipulates similarly.

¹⁶ See the justification of the decision of the Supreme Administrative Court in Warsaw of 9 May 2012, ref. no. I OSK 926/12, Lex No. 1166071

¹⁷ The Act on Freedom of Economic Activity of 2 July 2004, consolidated text: Dziennik Ustaw of 2013, item 672.

¹⁸ The Act on Goods and Services Tax of 11 March 2004, consolidated text: Dziennik Ustaw of 2011, No. 177, item 1054, as amended.

¹⁹ Official Journal L 347 of 11 December 2006.

In the jurisprudence the commune is regarded as one of the public authorities within the meaning of commented provisions. For example, the Provincial Administrative Court in Wrocław in its judgment of 5 March 2009 stated that the term 'public authorities' used by the legislator in Art. 15 para. 6 of the VAT Act has not been specified. However, based on the purpose of this regulation, it should be considered that it also covers local government units (including communes), as they undoubtedly perform public tasks imposed upon them by law²⁰.

In interpreting the provisions quoted above, it should thus be noted that a commune may acquire the status of VAT taxpayer by performing both tasks of public service nature and going beyond its scope, as long as the actions it takes do not fall within the scope of tasks it was entrusted with by separate law provisions. However, by undertaking the last of the identified actions the commune shall be a VAT taxpayer if its implementation occurs on the basis of civil law agreements.

Exclusion of public authorities and offices providing service for such authorities from the category of taxpayers referred to in these provisions is subjective and objective. It occurs when two prerequisites are met:

- subjective, since the exclusion applies only to public authorities, and
- objective, since it covers only the conduct of actions related to the exercise of public powers.

In its interpretation of this provision the European Court of Justice has repeatedly pointed out that for the application of Art. 4 para. 5 of the VI Directive it is necessary to meet two prerequisites – the activity must be carried out by a public law entity and it must be carried out in order to exercise the public power²¹. In its interpretation of the Community provisions in this field, the Court laid special emphasis on the element of competitiveness of the entity's actions. In its view, the activity of a public authority, which may materially affect the operation of private legal entities, as infringing the rules of competition, should be taxed.

Thus, when interpreting Art. 15 para. 6 of the VAT Act it should be assumed that the legislator had in mind the public authority exercising the administrative power

²⁰ See the justification of the judgment of the Voivodship Administrative Court in Wrocław of 5 March 2009, ref. no. I SA/Wr 1045/08, LEX No. 491808.

²¹ See, among others, judgments of the European Court of Justice of 25 July 1991, ref. no. C-202/90, and of 16 September 2008, ref. no. C-288/07

and not being in a position levelled with other economic operators²². The criterion for distinguishing acting of the local government body as public authority from acting as a taxpayer is whether this body acts as an authority or behaves like an entrepreneur²³. In other words, the condition for determining the recognition of a public authority as a VAT taxpayer is behaving not like an authority (and, therefore, in the sphere of *imperium*), but as an economic entity (acting in the sphere of *dominium*) in relation to certain transactions or actions²⁴.

It should be also noted that under Implementing Regulation to the VAT Act, exempt from the tax are also services rendered between budgetary units and budgetary local government establishments, with the exception of services mentioned in item 140–153, 174 and 175 of Annex 3 to the VAT Act and municipal transport services²⁵.

Practical problems

However, this seemingly clear distinction according to which the commune is not a VAT taxpayer if it acts in the sphere of *imperium*, and is when it carries out the activity in the sphere of *dominium*, irrespective of whether it has a nature of public service or goes beyond it, raises in practice many problems.

The main one is, of course, the qualification of individual actions as subject to taxation or exempt from it. The issues that needed resolving included, among others:

- tax exemption of fees for communal waste management²⁶,

²² See the justification of the judgment of the Supreme Administrative Court of 18 April 2012, ref. no. I FSK 953/11, publ. <http://www.orzeczenia.nsa.gov.pl> [last visited: 03.03.2016].

²³ See the justification of the judgment of the Provincial Administrative Court in Kraków of 6 March 2014, ref. no. I SA/Kr 60/14, publ. <http://www.orzeczenia.nsa.gov.pl> [last visited: 03.03.2016].

²⁴ See the justification of the judgment of the Provincial Administrative Court in Warsaw of 24 June 2008, ref. no. III SA/Wa 390/2008, LexPolonica No. 2274409.

²⁵ Art. 3 para 7 of the Resolution of the Minister of Finance of 20 December 2013 on exemption from goods and services tax and conditions of use of these exemptions, Dziennik Ustaw of 2013, item 1722.

²⁶ See the justification of the judgment of the Provincial Administrative Court in Rzeszów of 13 November 2012, ref. no. I SA/Rz 968/12, publ. <http://www.orzeczenia.nsa.gov.pl> [last visited: 03.03.2016].

- tax exemption of fees for the issuance of a permit for occupying the road lane against payment for purposes not related to the construction, repair, maintenance and protection of roads²⁷,
- whether fees for parking in car parks located outside road lanes constitute remuneration for the provision by the commune of parking services taxable with goods and services tax at the rate of 23%²⁸,
- lack of possibility to settle the goods and services tax in case of conclusion of an agreement of lending for use²⁹.

It is also important to remember that in the case of actions that are not subject to taxation with goods and services tax, the commune is not entitled to settle that tax based on invoices documenting the purchase of goods or services related to the performance of such action (and contrary to Art. 86 para. 1 of the Act).

Whereas communes that in a given tax year perform both acts that are taxable and non-taxable shall be required to apply the principles of partial deduction of tax under the provisions of Art. 90 of the VAT Act. The calculation of the proportion in which the taxpayer may reduce the amount of tax due by such amount of input tax may be particularly problematic in this regard. In context, attention should be drawn to the possibility arising from the provision of Art. 90 para. 8 of the VAT Act under which taxpayers who in the previous fiscal year did not reach the turnover referred to in paragraph 3, or whose turnover in the previous fiscal year was less than PLN 30,000, in order to calculate the amount of input tax deductible from the amount of tax due, assume an estimated proportion, according to the forecast agreed with the head of the tax office, in the form of a protocol.

The last of the problems, which now has already developed a uniform ruling practice, is the tax status of offices and other organisational units of a commune. That is, according to the current jurisprudence of administrative courts, only a com-

²⁷ See the justification of the judgment of the Supreme Administrative Court of 25 November 2011, ref. no. I FSK 145/2011, LexPolonica No. 3069277.

²⁸ The decision of the Director of the Tax Chamber in Łódź of 8 October 2011, Ref. No. IPTPP1/443-454/11-2/MW, publ. <http://sip.mf.gov.pl> [last visited: 03.03.2016].

²⁹ The decision of the Head of the Tax Office in Bydgoszcz of 7 May 2012, Ref. No. ITTP1/443-322/12/AP, publ. <http://sip.mf.gov.pl> [last visited: 03.03.2016].

mune, as a legal person, is entitled to the status of a taxpayer. Therefore, both communal offices³⁰ and their budgetary units³¹ do not have such status.

Conclusions

A commune has the right to pursue economic activity in accordance with the principles set out in the Constitution of the Republic of Poland, its constitutional act and the Act on Communal Economy. Although the scope of this activity is the widest of all local government units and may extend beyond the public service tasks, the performance of this type of activity may take place only if additional prerequisites laid down in the Act on Communal Economy are met.

The actions taken by the commune may be subject to taxation with goods and services tax if they may be considered as pursuing economic activity within the meaning of Art. 15 para. 2 of the VAT Act, which corresponds to the activity of a commune in the sphere of *dominium*. Whereas the activity of public entities remaining in the sphere of administrative power (*imperium*) is excluded from taxation.

The above dichotomous differentiation between the rules of taxation of the economic activity of a commune requires careful qualification of individual actions performed by such entities. In the case of actions which are not subject to goods and services tax it is not possible to settle the tax resulting from invoices issued to communes in connection with the execution of such task. Therefore, its incorrect classification creates the risk of obligation to correct the tax return and reimburse the wrongly deducted goods and services tax including interest. This type of receivables is treated as tax arrears.

Notwithstanding the foregoing, carrying out by a given commune both taxable and non-taxable actions requires keeping accurate settlements allowing separate

³⁰ See, for example, the judgment of the Supreme Administrative Court of 23 March 2010, Ref. No. I FSK 273/2009, LexPolonica No. 2252826; the judgment of the Provincial Administrative Court in Bydgoszcz of 3 March 2010, Ref. No. I SA/Bd 64/2010, LexPolonica No. 2809254; the judgment of the Supreme Administrative Court of 28 April 2009, Ref. No. I FSK 263/2008, LexPolonica No. 2332386.

³¹ See the Resolution of the Supreme Administrative Court of 24 June 2013, Ref. No. I FPS 1/13, publ. <http://ww.orzeczenia.nsa.gov.pl> [last visited: 03.03.2016].

identification of the amounts of input tax related to the actions in respect of which the taxpayer is entitled to reduce the amount of tax due.

Thus, depending on whether a given commune shall undertake actions resulting from the exercise of public powers or shall be a regular free market participant, either exclusion from goods and services tax or general principles of taxation shall apply.

This division is fully axiologically justified by the idea of economic freedom which assumes the existence of peer entities. Equality of rights should in fact translate also into the equality of duties, including tax obligations. Hence, communes carrying out actions within the scope of their *dominium* should be treated on an equal footing with other taxpayers. However, such interpretation cannot be justified in case of exercising an administrative power by these local government units. They cease then to be market participants and become the embodiment of state authority.

Thus, the article confirms the thesis proposed at the beginning that recognition of a commune as the payer of tax on goods and services is possible only to the extent of activities it undertakes within the scope of *dominium*. The confirmation of this thesis allows to resolve doubts emerging so far in practice as to the tax status of a commune. As a result, the objective of this paper has been achieved since the correct classification of activities undertaken by a commune with regard to tax on goods and services had been indicated.

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