

30. Contingent liabilities and assets

30.1 Material court, arbitration and administrative proceedings and other risks to the Parent or its subsidiaries

Material court proceedings to which the Parent is a party

There were no significant changes with respect to pending material court, arbitration, and administrative proceedings or with respect to other risks to the Company or its subsidiaries in the period between the end of the previous financial year, i.e. December 31st 2015, and the date of issue of these financial statements. For information on pending material proceedings, see [Note 35.1](#) to the *consolidated financial statements for 2015*.

Tax settlements

In 2015, the Company's VAT settlements for 2010–2011 were subject to two inspections by tax inspection authorities. On June 23rd 2015, the Company received post-inspection reports and challenged some of the findings contained in them. On September 30th 2015, the Company received two decisions issued by the Director of the Tax Audit Office in Bydgoszcz, by way of which the tax authority assessed the VAT payable by the Company for the period from January to December 2010 and from January to December 2011, identifying VAT arrears of PLN 48.4m for 2010 and PLN 112.5m for 2011. The Director of the Tax Audit Office stated in those decisions that certain transactions with two of the Company's trade partners involved fraudulent tax practices, arguing that the Company failed to exercise due care in executing transactions with those trade partners and that it should at least have been aware that the transactions were connected to and resulted from a tax fraud committed at an earlier stage, and therefore the Company had no right to make VAT deductions. Having reviewed the decisions, the Company dismissed the allegations of the Director of the Tax Audit Office as entirely groundless and on October 14th 2015 filed an appeal with the Director of the Tax Chamber in Gdańsk, who then upheld the decisions of the Director of the Tax Audit Office in Bydgoszcz, whereas the complaint lodged by the Company in the first half of 2016 with the Provincial Administrative Court was dismissed. As at the date of issue of these financial statements, both decisions of the Director of the Tax Audit Office in Bydgoszcz, assessing the VAT payable by the Company for individual months of 2010 and 2011, remained upheld. In Q3 2016, the Company lodged cassation complaints with the Supreme Administrative Court of Warsaw.

In 2016, the Company's VAT settlements for the period from November 2014 to September 2015 were subject to inspection by the Director of the Tax Audit Office in Gdańsk. In connection with the proceedings, following receipt of a post-inspection report on December 7th 2016, the Company submitted corrected VAT returns in which the input VAT amount was reduced by PLN 34.3m.

Regulations on value added tax, corporate income tax, and social security contributions are subject to frequent amendments, with the effect being lack of appropriate points of reference, conflicting interpretations, and scarcity of established precedents which could be followed. Furthermore, the applicable tax laws lack clarity, which leads to differences in opinions and diverse interpretations of tax regulations, both between various public authorities and between public authorities and businesses. Tax settlements and other areas of activity (e.g. customs or foreign exchange control) are subject to inspection by bodies which are authorised to impose high penalties and fines, and any additional tax liabilities arising from such inspections need to be paid with high interest. Consequently, tax risk in Poland is higher than in countries with more mature tax systems. The amounts presented and disclosed in the financial statements may therefore change in the future as a result of a final decision by a tax inspection authority.

On July 15th 2016, the Polish tax legislation was amended to reflect the provisions of the General Anti-Abuse Rule ("GAAR"). GAAR is intended to prevent creation and use of abusive arrangements to avoid paying taxes in Poland. Under GAAR, tax avoidance is an arrangement the main purpose of which is obtaining a tax advantage that is contrary to the objectives and purpose of the tax legislation. In accordance with GAAR, no tax advantage can be obtained through an arrangement if the arrangement was abusive. Any arrangements involving (i) separation of transactions or operations without a sufficient rationale, (ii) engaging intermediaries where no business or economic rationale exists, (iii) any offsetting elements, and (iv) any arrangements operating in a similar way, may be viewed as an indication of the existence of an abusive arrangement subject to GAAR. The new regulations will require much more judgment to be exercised when assessing the tax consequences of particular transactions.

The GAAR clause should be applied with respect to arrangements made after its effective date as well as arrangements that were made before its effective date but the benefit of the tax advantage obtained through the arrangement continued or still continues after that date. After the new regulations are implemented, Polish tax inspection authorities will be able to challenge certain legal agreements and arrangements made by taxpayers, such as corporate restructurings.

Court proceedings instigated by or against companies of the LOTOS Group

Agreement signed by LOTOS Exploration and Production Norge AS

LOTOS Exploration and Production Norge AS ("LOTOS E&P Norge AS") was a party to proceedings held before an arbitration court in Norway in connection with claims filed by Single Buoy Moorings Inc. ("SBM"), the supplier of a MOPU (Mobile Offshore Production Unit) for the operation of the YME field, against Talisman Energy Norge AS, the operator of the YME field ("Talisman", the "Operator") and the other YME licence holders. The share of SBM's claims attributable to LOTOS E&P Norge AS was 20%.

In 2013, Talisman Energy Norge AS ("Talisman", the then operator of the YME field) and Single Buoy Moorings Inc. ("SBM", owner of the MOPU) announced that an agreement was reached to terminate all existing contracts and agreements executed by the parties in connection with the YME project and remove the defective MOPU from the YME field.

SBM paid USD 470m to the consortium members, and Talisman Energy, on behalf of the licence holders, agreed to make the necessary preparations and remove the platform from the field. Under the agreement, SBM was responsible for towing the MOPU to the port and its scrapping, whereas following completion of certain works, the ownership of elements of the YME field in situ subsea infrastructure delivered by SBM should be transferred to the consortium members, who would be required to perform reclamation (and disassembly) activities related to the infrastructure. Each of the parties will cover the costs of its scope of decommissioning work as set out in the agreement.

In accordance with the provisions of the agreement made with SBM, the balance of the Group's share in the amount due to the consortium members under the agreement, that is USD 81.78m, was transferred to the YME project escrow account, to be gradually released to finance the removal of the MOPU and related infrastructure from the field, in accordance with the agreement.

On August 22nd 2016, the YME project partners completed evacuation of the defective MOPU from the field. The remaining work, i.e. cutting the MOPU legs and installation of the temporary caisson support (element of the subsea infrastructure), is under way and should be completed by June 2017 at the latest.

As at December 31st 2016, available cash deposited in the escrow account, denominated in the presentation currency, was recognised in the amount of PLN 75,284 thousand under *other assets* in the statement of financial position. The available provision for future costs of removal of the MOPU and disassembly of the related fixed assets was recognised in the amount of PLN 13,065 thousand under the current portion of *other liabilities and provisions*. The amount of expected costs of the operation (most of which had been already contracted) was correctly reflected in these financial statements by updating relevant provisions in accordance with the best current knowledge of the Company's Management Board as at the date of these statements (see [Note 26.1](#)).

Tax settlements of LOTOS Exploration and Production Norge AS

In the twelve months ended December 31st 2016, the income tax settlements of LOTOS Exploration and Production Norge AS ("LOTOS E&P Norge AS") for 2013–2014 were investigated by the Norwegian Oil Taxation Office (the "OTO"). On June 1st 2016, LOTOS E&P Norge AS received a notice of May 31st 2016 requesting the company to provide explanations. In the notice, the OTO questioned recognition of some of the finance costs incurred by LOTOS E&P Norge AS in 2013|2014 as tax deductible expenses due to the company's thin capitalisation in that period. Considering the risk of a dispute with the taxation authority and the company's financial position in the period 2013–2014, to which the OTO referred, as well as the fact that the company applies the same approach to the period 2015–2016, LOTOS E&P Norge AS, taking into account the adverse effect of its thin capitalisation, made an assessment as at December 31st 2016 of its ability to realise deferred tax assets on account of tax losses carried forward, and in 2016 made a downward revision of the deferred tax asset amount by PLN 80.9m. As at the date of issue of these financial statements, the proceedings were pending.

In the twelve months ended December 31st 2016, there were no material settlements under court or other proceedings, save for those presented above.

30.2 Other contingent liabilities

In the period between the end of the previous financial year, i.e. December 31st 2015, and the date of issue of these financial statements, there were no changes in the Company's or its subsidiaries' other material contingent liabilities (see [Note 35.2](#) to the *consolidated financial statements for 2015*).

For presentation of the Group's off-balance-sheet future investment commitments, see [Note 13.3](#).

The Notes to the consolidated financial statements are an integral part of the statements.
(This is a translation of a document originally issued in Polish)