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Tax Review

Dentons Poland
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Note from the editor

Dear Sirs,

We are proud to present the next edition of our "Tax Review" which contains a selection of rulings and interpretations that had been issued or published in June 2014. I hope you will find the information provided here helpful and of interest.

If you would like to share Dentons' insights with friends or co-workers, please send their name, business position and e-mail address to: dentonstaxadvisory@dentons.com

Sincerely yours,

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Prerequisites of exempting a foreign charitable organization obtaining income in Poland from CIT

Ruling description

The Provincial Administrative Court in Warsaw in its judgment of June 10, 2014 (case file no. III SA/Wa 3037/13) reversed a tax ruling in which the Minister of Finance refused tax exemption to a British charitable organization.

A charitable society operating in the UK applied for a tax ruling determining whether a corporate income tax (CIT) exemption was applicable to its income obtained in Poland. In the presentation of its position the association pointed out that the linguistic and systematical interpretation of Art. 17 sec. 1 point 6c of the CIT Act allows a statement that an organization set up and operating under British law for public benefit also enjoys the exemption. According to the society, the correct interpretation of Art. 17 sec. 1 point 6c of the CIT Act is that the society enjoys the CIT exemption with respect to income obtained in Poland in the part earmarked for the statutory activities of the society, even if conducted outside Poland and without enjoying the status of a public benefit organization in Poland.

The tax authority considered that the applicant's position was incorrect, based on the fact that the society did not satisfy all the necessary conditions listed in Art. 17 sec. 1 point 6c of the CIT Act. The literal wording of the above regulation provides that the tax exemption is applicable to the income of a public benefit organization referred to in the regulations concerning public benefit organizations and volunteering in the part earmarked for statutory activities, excluding business operations. In the above article the legislator does not provide for any exemption applicable to foreign entities, which, according to the authority, excludes the possibility of a tax exemption for a foreign society.

The Provincial Administrative Court in Warsaw reversed the above tax ruling and pointed out that the issue of whether income obtained by the society earmarked in its entirety for statutory activities is subject to the CIT exemption should be assessed taking into consideration the judgment issued by the European Court of Justice dated September 14, 2006 in case C-386/04 (Centro di Musicologia Walter Stauffer). In the above judgment the court resolved that the EC Treaty prohibits a member state which grants an income tax exemption with respect to lease income obtained in that member state by domestic foundations (regarded as public benefit organizations, which are generally subject to an unlimited tax obligation) with their registered offices in that member state, from refusing the same exemption of the same type of income to a private law foundation classified as a public benefit organization based only on the fact that because it has its registered office in another member state it is subject to limited tax liability only.

The Court pointed out that when re-issuing the tax ruling the authority should explicitly consider and take a stance on the case in the context of the above ECJ judgment and take into account other CIT regulations, pursuant

to which the society could also enjoy a tax exemption, in particular Art. 17 sec. 1 point 4 of the CIT Act, in accordance with which the income of taxpayers whose statutory purposes include, among others, cultural, charity, health protection and social care activities, are subject to exemption in the part earmarked for these purposes.

Comment

The above judgment opens up a discussion on the application of the tax exemption set forth in Art. 17 sec. 1 point 6c of the CIT Act not only to Polish public benefit organizations, but also to similar organizations set up under the laws of other EU member states. When re-examining the case, the authority will be obligated to refer to the issue of discrimination against foreign public benefit organizations in the context of the ECJ judgment issued in case C-386/04.

The said judgment is also interesting from the point of view of the procedural rules of issuing tax rulings, as the court confirmed the thesis that a tax authority may not reduce the scope of a tax ruling to statutory provisions only (i.e. articles and other editorial units) specified by the applicant, but it is also obligated to take into consideration other material law regulations which the applicant has not mentioned in its submission, but which are applicable to the case.

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If an overpayment is determined as a result of submission by a taxpayer of a certificate of residence a remitter shall return the collected remuneration together with default interest

Ruling description

In its judgment of June 30, 2014, case file no. II FSK 1725/12, the Supreme Administrative Court resolved that if an overpayment is determined on the taxpayer's part the remitter is obligated to return the collected remuneration together with default interest. Therefore, the remitter which as of the date of payment of a dividend collected tax in the proper amount is under sanction connected with a future declaration of overpayment in favor of the taxpayer.

A fund seated in the US (the taxpayer) applied to the head of a tax office for a declaration of overpayment of withholding tax on the dividend paid by the bank (the remitter). The fund questioned the amount of the tax of 19% collected by the remitter claiming that the fund is a US resident, hence the treaty on the avoidance of double taxation concluded between Poland and the USA, which provides for a 15% tax rate on this type of income, should be applied to the settlement of the tax.

The bank withheld tax at a higher rate, because the fund did not submit a certificate of tax residence. When transferring the tax to a tax office's account the bank, as the remitter, deducted remuneration for timely payment of taxes equal to 0.3% of the collected tax (Art. 28 § 1 of the Tax Ordinance in conjunction with § 1 sec. 1 point 1 of the Regulation of the Minister of Finance of December 24, 2002 on remunerating remitters and collectors collecting taxes for the state budget - hereinafter: the Regulation).

The head of the tax office declared, in accordance with the taxpayer's application, an overpayment of withholding tax. In relation to the refund of the above overpayment the base for the determination of the flat rate remuneration due to the remitter also changed and the head of the tax office resolved on the reimbursement of the remitter's remuneration unduly collected by the bank, as pursuant to Art. 28 § 1 of the Tax Ordinance and § 2 of the Regulation, if it is declared that a remitter or a collector collected an undue remuneration or remuneration in excess of the amount due, a tax authority shall issue a decision on the return of the undue remuneration to the account of the competent tax office and the remitter is obligated to return the undue remuneration to the bank account of the competent tax office together with default interest.

The bank appealed against the above decision, but the Director of the tax chamber upheld the decision of the first instance authority. The case was remanded to the Provincial Administrative Court, which, in its judgment of March 6, 2012 (case file no. III SA/Wa 1856/11) reversed the decision on appeal. In the statement of grounds it stated that pursuant to Art. 26 sec. 1 sentence 2 of the CIT Act, the application of the tax rate arising from a respective Treaty on the avoidance of double taxation or a failure to collect the tax in accordance with the treaty is permissible provided that the place of the taxpayer's seat for tax purposes is evidenced by a certificate of tax residence submitted by the taxpayer. According to the court, the role of a remitter consists in three technical (accounting) operations, i.e. the calculation of the tax due from the taxpayer, collecting the tax from the taxpayer's funds and payment of the tax to the proper tax authority by the statutory deadline.

From what was established during the proceedings regarding the declaration and refund of the overpayment, it arises that at the date of payment of the dividend and collection of the tax the said certificate had not yet been issued to the fund. According to the trial court, based on the factual background, the remitter properly performed its obligations as of the date of collecting the tax as the amount of the tax collected on the remittance day was consistent with the provisions of the substantive tax law.

The tax authority filed a last resort appeal against the judgment of the Provincial Administrative Court in Warsaw. The Supreme Administrative Court reversed the judgment on appeal and remanded the case to the Provincial Administrative Court in Warsaw. In the statement of grounds it pointed out that Art. 28 of the Tax Ordinance is a clear regulation and the proper amount of tax may only be one, hence despite the submission by a taxpayer of the certificate of tax residence at a later date, the proper tax should be collected in accordance with the provisions of the treaty on the avoidance of double taxation. According to the court, it can hardly be stated that the state contributed to the collection of undue remuneration. On the other hand, the remitter's situation is quite special, as its role is to facilitate the collection of taxes. It is paid remuneration for the same, so it should collect taxes in the proper manner.

Comment

The Supreme Administrative Court's position is an important warning signal for remitters of income tax: the remitter must take into consideration that the taxpayer may apply for refund of an overpayment, as a result of which the remitter may be obligated to return the remuneration together with default interest.

Bearing in mind the penal effects of the said judgment, a remitter should consider postponement of the collection of the remuneration until final confirmation that the taxpayer did not effectively question the amount of the collected tax i.e. until the decision on the refusal to declare the overpayment or expiry of the deadline for the submission of an application to that effect (generally - five years from the end of the year in which the deadline for payment of the tax expired). However, executive provisions do not envisage any procedure for the recovery of the due remuneration, which generally should be deducted from the collected tax.

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No possibility of PCC refund in the case of repealing a resolution on the increase in a company's share capital

Ruling description

The Supreme Administrative Court in its judgment of June 11, 2014 (case file no. II FSK 1663/12) resolved that provisions of the PCC Act concerning refund of this tax do not provide for a situation where the company's capital was registered in the National Court Register and then, a few months later, following the repeal of a resolution on the increase in the company's share capital, the said entry was deleted. According to the court, the above situation does not serve as grounds for a refund of the tax paid on amendment of the company's Articles of Association. As a result, even if a resolution on the increase in the company's share capital was registered by mistake, this is irrelevant as far as the civil law transactions tax is concerned.

Comment

The judgment above concerns an increase in share capital on the basis of the so-called authorized capital, which involves an authorization granted to the company's management board, for a period of up to 3 years, to increase the company's share capital. The said increase may be effected by the company's management board in one or more issues, but in each case it requires amendment of the company's Articles and registration of the increase in the National Court Register. An indisputable advantage of the above solution is its simplicity, as the increase is effected by the management board within the scope of its competence under the Articles of Association, without any need to adopt an additional resolution of the general meeting. Additionally, this manner of increasing the share capital reduces the costs of obtaining the capital and facilitates a quick issue of shares at the most convenient time.

For the purposes of the civil law transactions tax, the tax point is the time of adopting a resolution on the increase in the company's share capital, irrespective of the time of its entering in the National Court Register. Nevertheless, if the increase in the share capital is not registered or is registered with respect to an amount below the one specified in the resolution, PCC is subject to being refunded in the part equal to the difference between the tax paid and the tax due on the increase in the share capital disclosed in the register of entrepreneurs. Additionally, it is worth mentioning that the PCC Act includes a closed-ended catalogue of situations where the tax is subject to being refunded.

In the situation analyzed above, the general meeting adopted a resolution on the increase in the authorized capital, but as the result of a mistake, the registry court registered an increase in the company's share capital. The above resolution was then repealed by the general meeting and the entry was deleted from the register at the company's request.

The Supreme Administrative Court considered that the company repealed the resolution with future effect; therefore, in this specific state of affairs, a regulation on the PCC refund is not applicable, as the increase in the company's share capital was first registered and then the respective entry was deleted by the registry court.

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The amounts paid in respect of the early termination of a lease are subject to VAT

Ruling description

The Supreme Administrative Court's judgment of 10 June 2014 (file ref. I FSK 981/13) indicated that the amount paid by a tenant or a landlord in connection with the early termination of the lease should be treated as part of remuneration under the agreement, which is subject to VAT. Therefore, the behavior of the tenant, involving the exercise of the right to the early termination of a lease agreement does not constitute a source of harm to the company which would involve the need to pay compensation. The payment for the loss of the rent benefits in connection with the early termination of the lease agreement when the landlord agreed for such a situation in advance should not be regarded as non-VATable compensation.

Comment

The court judgment provides important guidance for those making settlements in connection with the early termination of the lease agreement which provides for such payments (which are often referred to as compensation or contractual penalties in lease agreements). The court upheld the position of the tax authorities and the court of first instance, that this qualifies as services rendered for remuneration which, in this case, is being paid in exchange for agreeing to terminate the lease prematurely. The Court emphasized that contractual arrangements cannot be used to adjust taxation relationships due to the fact that this could be abused to circumvent the law.

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Disposal of shares in a partnership limited by shares (SKA) which had been subscribed for in return for non-monetary contributions – sessed in accordance with Art. 22 Sec. 1f Clause 1 of the PIT Act

Ruling description

The aforementioned judgment of the Supreme Administrative Court was issued on June 26, 2014 (case file no. II FSK 3224/13). It concerns the assessment of tax costs upon the disposal of shares in an SKA in a situation where the shares had been subscribed for in return for an in-kind contribution. In the court's estimation, the linguistic interpretation of Art. 22 Sec. 1f Clause 1 of the PIT Act explicitly suggests that in the case of the sale of shares subscribed for in return for a non-monetary contribution, the cost of generating revenue equals the nominal value of the shares as at the subscription date. The teleological and functional interpretations are only auxiliary measures and may not lead to the negation of the essence or sense of a legal norm which transpires from the literal wording of the norm in question.

The taxpayer applied for a written interpretation of tax regulations in a case involving PIT. In his application, the taxpayer explained that he was a shareholder in an SKA and that he intended to join another SKA in the same capacity. In connection with his intention, the taxpayer intended to make monetary and non-monetary contributions to the newly formed partnership. The non-monetary contributions were not meant to involve an enterprise or an organized part thereof. In return for the monetary and non-monetary contributions the taxpayer would receive shares in the partnership limited by shares, the nominal value of which would equal the value of the monetary contributions and the market value of the non-monetary contributions. In the future, the taxpayer intended to transfer the shares subscribed for in the partnership limited by shares against remuneration in return for non-monetary and monetary contributions. He also expected to transfer the shares against remuneration to the partnership limited by shares for redemption.

In his tax ruling, the Director of the Tax Chamber in Łódź agreed with the taxpayer's submissions relating to shares acquired in return for a monetary contribution, and contested the taxpayer's stance in relation to the shares subscribed for in return for a non-monetary contribution. In the statement of reasons, the Director explained that the taxpayer failed to take into account that an in-kind contribution to a partnership is a tax neutral transaction which is not a paid disposal or taxable subscription of shares in return for a non-monetary contribution. This means that the nominal value of shares as at the day of subscription by the shareholder may not be treated as the cost of the acquisition of shares in an SKA, since the in-kind contribution to the partnership does not trigger any taxable revenue. In the present case, the tax deductible costs would equal the costs incurred by the taxpayer upon the acquisition of the in-kind contribution. In the tax authorities' estimation, the interpretation suggested by the taxpayer would put shareholders of SKAs in a privileged position as compared with shareholders of joint stock companies (or limited liability companies), who would treat the nominal value of shares as the cost of generating revenue since the same nominal value of the shares had previously been a taxable revenue. This would distort the interrelation between the subscription for shares and disposal thereof in terms of assessing the taxable revenue and the tax deductible costs provided by the legislators in the Act. Notably, the Constitution does not provide for any premises allowing tax authorities to afford different

treatment to shareholders on the basis of the same regulations only because there is no legal basis for taxing income generated by the shareholders of a partnership on account of subscription for shares at their nominal value, as is the case with shareholders of companies limited by shares.

The case was referred to the Voivodship Administrative Court in Łódź, which did not approve the taxpayers' submissions and dismissed the appeal. Consequently, the Supreme Administrative Court affirmed the taxpayer's stance, holding that the tax cost upon the disposal of shares in an SKA, which had originally been subscribed for in return for an in-kind contribution, will equal the nominal value of the shares.

Comment

The Supreme Administrative Court was correct in that there are no grounds for any interpretation of Art. 22 Sec. 1f Clause 1 of the PIT Act other than the linguistic, grammatical interpretation. The linguistic interpretation explicitly suggests that the cost of generating revenue in the case of the sale of shares previously subscribed for in return for a monetary contribution equals the nominal price of the shares as at their subscription date. The teleological or functional interpretations are only auxiliary measures and may not lead to the negation of the essence or sense of a legal norm which may be derived from the literal wording of the norm in question.

Due to general theses formulated by the court regarding the priority given to linguistic interpretation over teleological or functional interpretations, the judgment will be essential for other matters concerning corporate restructurings involving SKAs awaiting consideration by the Supreme Administrative Court.

Equally importantly, the Supreme Administrative Court took a similar position in the judgments issued on April 2, 2014 (case file no. II FSK 2671/13 and II FSK 2673/13) and July 3, 2014 (case file no. II FSK 1237/14). Consequently, we may speak of a line of Supreme Administrative Court jurisdiction which is advantageous to taxpayers in terms of the tax consequences of disposals of shares in SKAs in return for non-monetary contributions.

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CIT on debt conversion by offsetting claims

Ruling description

Contrary to the dominant doctrinal views and the universal practice regarding debt for equity swaps, the Supreme Administrative Court stated in its judgment of 25 June 2014 (file ref. II FSK 1799/12), that a conversion of debt into share capital effected in accordance with specific provisions of the bankruptcy law, must at all times be classified for tax purposes as a contribution in kind. This means that a creditor should recognize revenue achieved on the nominal value of the shares acquired, but cannot recognize any associated tax deductible costs.

The bank recognized taxable income achieved on claims arising from the settlement of derivative contracts entered into with its client. In connection with the bankruptcy of the client, an arrangement was subsequently adopted and approved by the court, which allowed for the direct conversion of these claims into shares of the bankrupt debtor. This possibility is specifically provided for in the bankruptcy law; such a , conversion replaces any corporate actions of the debtor related to the share capital increase and constitutes a direct basis (together with a copy of a final order approving the arrangement) to enter the capital increase of the company in the National Court Register. It was outlined in the documents relating to the arrangement that the new shares will be considered as acquired in exchange for a cash contribution. This is deemed to be made upon the set-off of the converted claims against the debtor's claim for coverage of the new shares. In these circumstances, the bank requested an individual ruling on the tax implications of the above conversion in relation to any CIT liabilities that may arise.

The tax authorities classified the conversion of debt into shares of the debtor as a contribution in-kind. As a result, it was held that the bank should recognize taxable revenue in the amount of the nominal value of the shares acquired. What's more, the tax authorities also stressed that, in accordance with the tax regulations applicable to in-kind contributions, only the expenditure actually incurred in connection with the acquisition of the items contributed in kind is deductible. As a result, since the contributed claim was in fact the bank's own claim (which was not acquired from any third party), the tax authorities held that no tax-deductible costs may be attributed to the claim that could be recognized by the bank in connection with the conversion.

The Bank filed a complaint against this ruling, but the Administrative Court (WSA) in Warsaw fully shared the position of the tax authorities, like the NSA, to whom the case was brought in connection with the cassation complaint of the bank. The courts of both instances had adopted a restrictive interpretation of the term "cash contribution" recognizing that it can be performed only by money transfer or bank transfer. In addition, both the WSA and the NSA recognized this conversion as a direct exchange of claims for other assets (shares or stocks), which is supposed to justify its classification as a contribution in kind, especially taking into account the restrictive understanding of what is a cash contribution by courts in the case.

Comment

The above judgment of the Supreme Administrative Court was issued in a situation involving a particular form of conversion, provided for in the bankruptcy law. It was carried out directly through the simultaneous

acquisition of new shares and the annihilation of debts without reference to any resolution or contractual set-off of claims. Apart from the description of the conversion specified by the bank, this operation significantly differs in legal terms to a typical conversion carried out under the general provisions of civil and commercial law, which is based on a cash contribution and the set-off of the converted claims against the claim for coverage of shares (stocks) with cash.

Nevertheless, the arguments of the NSA described in this case show that the position of the court could also be used in other cases as arguments for the recognition of an ordinary conversion performed by offsetting receivables as a form of contribution in kind. This is all the more tenable as such a secluded position has sometimes appeared in the jurisprudence of the Supreme Administrative Court (compare esp. judgment of the Supreme Administrative Court of 28 February 2005, file ref. FSK 1434-1404). Such operations have recently been widely used in business practice as an optimal form of debt restructuring, expressly permitted by law and repeatedly accepted by the tax authorities. The consequence of the court's position would be the double taxation of the same income in connection with the accrual of claims, and then in connection with their conversion (without the possibility to identify any significant cost in case of the conversion of one's own claims). Such a situation would also grossly contravene the hitherto dominant fiscal practice (the monetary nature of the contribution associated with the conversion was confirmed by the Director of the Tax Chamber in Katowice, in his ruling of 30 April 2014, file ref. IBPBII/2/415-153/14/MMa; see also for example, the ruling of the Director of the Tax Chamber in Łódź of 17 October 2013, file ref. IPTPB2/415-499/13-2/KR) and case law (see for example the judgments of Administrative Court in Warsaw of 10 May 2013, file ref. III SA / Wa 3497/12 and III SA / Wa 3498/12, and before eg. the precedential judgment of the Supreme Administrative Court of 14 December 2004, file ref. FSK 2066/04, in which the court held that whether a conversion of debt into shares takes the form of cash or contribution in kind should be determined by the content of the relevant corporate resolution). It is worth noting though that the tax authorities have sometimes questioned the cash nature of a conversion associated with a set-off, but only in the context of specific tax provisions not related directly to the taxation of the contribution, that use the general term of capital covered with receivables (as for example in the context of thin capitalization, see the ruling of the Director of the Tax Chamber in Warsaw of 10 July 2013, file ref. IPPB3/423-337/13-2/AG).

In our opinion, in the case of an ordinary conversion (carried out under the general provisions of civil and commercial law) the position of the NSA would not be justified. It omits completely the effects of the principle of contractual liberty of the parties, as well as the content of corporate documents prepared by the company and the creditor and constitutive court decisions on the registration of the increase of the share capital. This position would also be incompatible with the postulate of legal certainty because it gives significant powers of discretion to the tax authorities in classifying the corporate operations carried out by taxpayers in cases where no circumvention of tax law could be invoked,

on the basis of arbitrary and vague evaluation criteria. However, regardless of these arguments, the further development of the case law should be carefully monitored (in particular, in the near term judgment of the Supreme Administrative Court on an appeal in cassation to the above-mentioned favorable judgments (for taxpayers) of the Administrative Court in Warsaw of 10 May 2013, is expected) and fiscal practice in this field in order to avoid unnecessary risks with the planned transaction. In regard of past transactions, it is worth preparing the material and arguments in the case of a possible dispute, which in our opinion is likely to produce a positive ruling.

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