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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 August 2015. 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,

Karina Furga-Dabrowska
Partner
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Excise duty on electricity used in mineralogical processes

Ruling description

The Supreme Administrative Court in its ruling handed down on August 20, 2015 (case file number: I FSK 869/15) ruled that the consumption of electricity by the company and used in mineralogical processes will be subject to excise duty.

The currently binding provisions of the Excise Duty Act impose excise on electricity (PLN 20.00 per megawatt hour). The list of available excise duty exemptions does not include an excise duty exemption on electricity used in mineralogical processes. Pursuant to Article 2 Section 3 Letter b tiret 5 of the Energy Taxation Directive (2003/96/EC), mineralogical processes are not encompassed by this directive.

In the discussed case, the NSA assessed the consistency of the Polish law with the EU regulations. The NSA based its ruling on the case C-349/13 decided by the Court of Justice of the European Union concerning legitimacy of imposing excise duty on lubricating oil. The Court ruled that the fact that a given product in not covered by the Energy Taxation Directive (2003/96/EC) or the Horizontal Directive (2008/118/EC) does not mean that a member

state cannot impose excise duty on it. The NSA found that the heart of the problem in the discussed case is the same, hence Poland was entitled to impose excise duty on electricity consumed in mineralogical processes.

Comment

The NSA's ruling is disadvantageous for entities purchasing and using electricity for industrial processes. It should be stressed, however, that the NSA's thesis will soon lose its relevance since on January 1, 2016 new amended provisions on excise duty will come into effect broadening the scope of the excise duty exemptions.

The excise duty exemption will cover, among others, electricity used for the purposes of chemical reduction, in electrolytic processes, metallurgic processes and mineralogical processes. The amendment will thus allow reducing the costs of the excise duty paid by the industrial facilities which to that date have not been benefiting from any of the available exemptions. Application of the said exemptions will depend on the satisfaction of additional conditions. Please note that the aforementioned excise duty exemption currently functions, in a similar form, in relation to coal and gas products. When applying the new excise duty exemptions to electricity, it will be possible to refer to the already developed practice regarding the excise duty exemptions for coal and gas products used in mineralogical, electrolytic and metallurgic processes and for chemical reduction.

The basic purpose of the amendment is to equalize the competitive position of the Polish businesses and the businesses from other EU states. Hence, the amendments concerning the excise duty may have a positive influence on your business. In view of the fact that the amendment will come into effect in 2016, it is necessary to take preparatory actions to fully benefit from the solutions offered by the new Act.

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Transfer of shares for redemption without the risk of a tax assessment by tax authorities

Ruling description

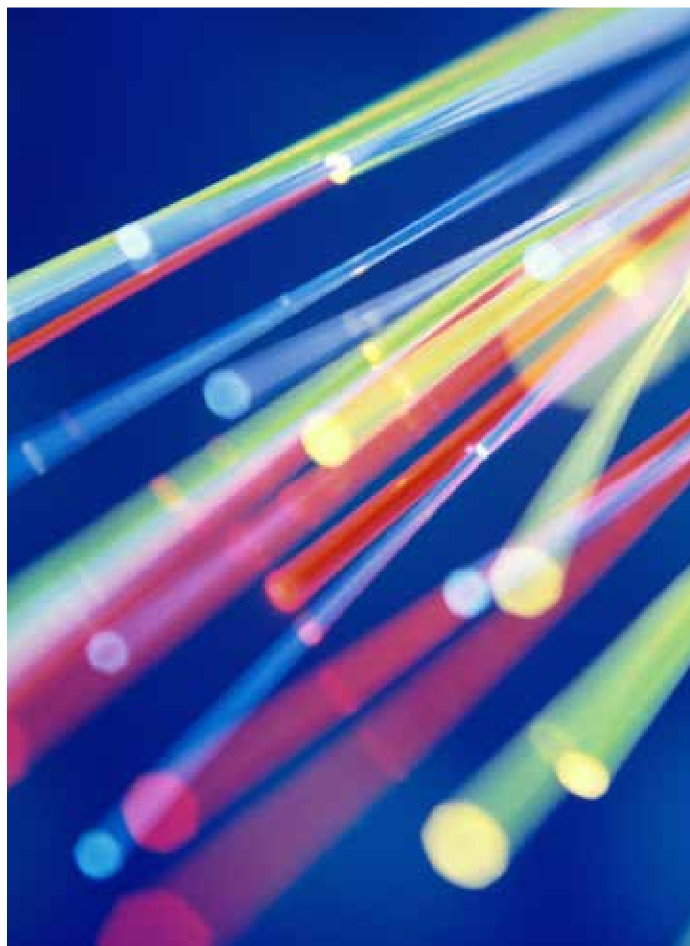
In thejudgment of August 19, 2015 (case file no. II FSK 1747/13) the Supreme Administrative Court ruled, consistently with its previous rulings, that in the case of a transfer of shares for redemption at a remuneration lower than their market value, the tax authorities do not have the discretion to prepare their own assessment of the income generated by the shareholder as a result of the transfer. In accordance with tax regulations, income on account of a paid transfer of assets or property rights is generally assessed on the basis of their contractual price. However, if the remuneration is substantially different from the market value of the assets or rights so transferred without any apparent reason, the tax authority has the discretion, under Art. 14 Sec. 1 of the CIT Act, to assess this income at the level of the market value.

The case resolved by the Supreme Administrative Court (NSA) concerned a Polish joint stock company which held 100% shares in a Polish limited liability company, and intended to transfer some of these shares to that limited liability subsidiary for redemption. The shares had been originally subscribed for and acquired in return for an in-kind contribution not constituting an enterprise or an organized part of the enterprise. The shareholder and the subsidiary intended to specify remuneration for the aforesaid share transfer at the nominal value of the shares which was likely to be lower than their market value. In the transaction at issue, the acquisition cost of the shares transferred was almost identical to their nominal value, thereby practically eliminating any CIT liabilities on the account of the transaction.

In connection with the planned transaction, the shareholder applied for a tax ruling to confirm that the aforesaid Art. 14 Sec. 1 of the CIT Act would not apply to the transaction, meaning that the tax authorities will have no right to assess income generated as a result of the share transfer for redemption at a value higher than that agreed by the parties, based on the market value of the shares. The Director of the Tax Chamber in Łódź issued a negative tax ruling, which was subsequently upheld by the Provincial Administrative Court in Łódź pursuant to an appeal filed by the shareholder. The tax authority and the Provincial Administrative Court pointed out that starting from January 1, 2011, income on account of share transfers for the purpose of redemption has been subject to the general provisions of the CIT Act (formerly, they had been classified as distributions of corporate profits and therefore subject to special regulations). As a result of the legislative change, the aforesaid income was made subject to general regulations regarding taxable income provided in Art. 12 Sec. 1 of the CIT Act. Notably, this provision contains an explicit reference to Art. 14 of the CIT Act, which suggests the possibility of tax authorities verifying the fair market value of the remuneration received in connection with a transfer of shares for voluntary redemption on the basis of this regulation.

Notwithstanding the above, in considering the last resort appeal, the Supreme Administrative Court agreed with the argumentation presented by the taxpayer, referring primarily to the literal interpretation of Art. 14 Sec. 1 of the CIT Act. The Supreme Administrative Court ruled that the transfer of shares for redemption is a special legal

transaction which cannot be classified as a paid transfer of assets or rights. Additionally, Art. 14 Sec. 1 of the CIT Act uses the notion of "price", whereas in the case of a transfer of shares for redemption we are dealing merely with "remuneration". Moreover, the Court noted that the commercial law expressly permitted share transfers for redemption without any remuneration being offered, in which case no additional income could be assessed for the shareholder in connection with a transfer transaction. After all, in the present transaction, certain remuneration (if lower than the share market value) has been agreed. The Supreme Administrative Court also found several arguments supporting the above view by applying an internal systemic interpretation, namely identifying a number of CIT Act provisions determining the rules for assessing income on account of acquisition or transfer of shares, which only proves that the general income assessment regulations cannot apply to transactions involving a transfer of shares for redemption. Additionally, based on the external systemic interpretation, the Supreme Administrative Court pointed out that in the case of other taxes, such as tax on civil law transactions (PCC), share transfers for the purpose of redemption are also treated as a special legal transaction different to a share transfer pursuant to a standard share purchase agreement and for this reason they should not be assessed in accordance with the general rules applicable to the given tax.



Comment

The Supreme Administrative Court judgment may raise certain doubts as to the formal correctness of the argumentation used in the judgment. That said, it is another consistent judgment regarding the application of Art. 14 Sec. 1 of the CIT Act to voluntary share redemptions (cf. Supreme Administrative Court judgment of February 19, 2015, case file no. II FSK 399/13 and previous NSA judgments handed down in 2013 – 2014, referred to in the judgment). Interestingly, tax authorities have recently tended to take a more favorable approach in similar cases, adding that the transfer pricing regulations did not apply to this types of transactions either (e.g. tax ruling issued by the Director of Tax Chamber in Katowice, dated July 2, 2015, case file no. IBPB-1-3/4510-98/15/AW). At this point it needs to be noted that for some time now the tax authorities have in their practice supported the view that Art. 14 Sec. 1 of the CIT Act and the transfer pricing regulations are also inapplicable in case of the share transfers for the purpose of redemption if no remuneration is paid (e.g. tax ruling issued by the Director of Tax Chamber in Katowice, dated July 14, 2014, case file no. IBPBI/2/423-438/14/PC). This transaction is also commonly deemed exempt from tax on civil law transactions (PCC), regardless of whether or not any remuneration is paid.

The above line of jurisprudence adds to the attractiveness of share redemption as a tax-optimization tool in restructuring the capital structure of companies, including in the case of partial withdrawal of an investment by a shareholder without realizing capital gains or in the case of the intention of taking over attractive tangible assets owned by the subsidiary. A share transfer for redemption may be effected without remuneration or with remuneration fixed below the cost of generating revenue in connection with the shares. However, in the light of the Supreme Administrative Court judgment, this transaction is unlikely to involve the risk of the tax authorities assessing the value of income generated by the shareholder at the level of the market value of the shares so transferred. A share redemption may therefore be an interesting solution for a number of corporate restructurings targeted at multiple business objectives. That said, before implementing this solution, further development of case law needs to be monitored and the risk of a potential dispute with tax authorities also must be factored in, although considering the above judgments, a hypothetical lawsuit is likely to be successful.

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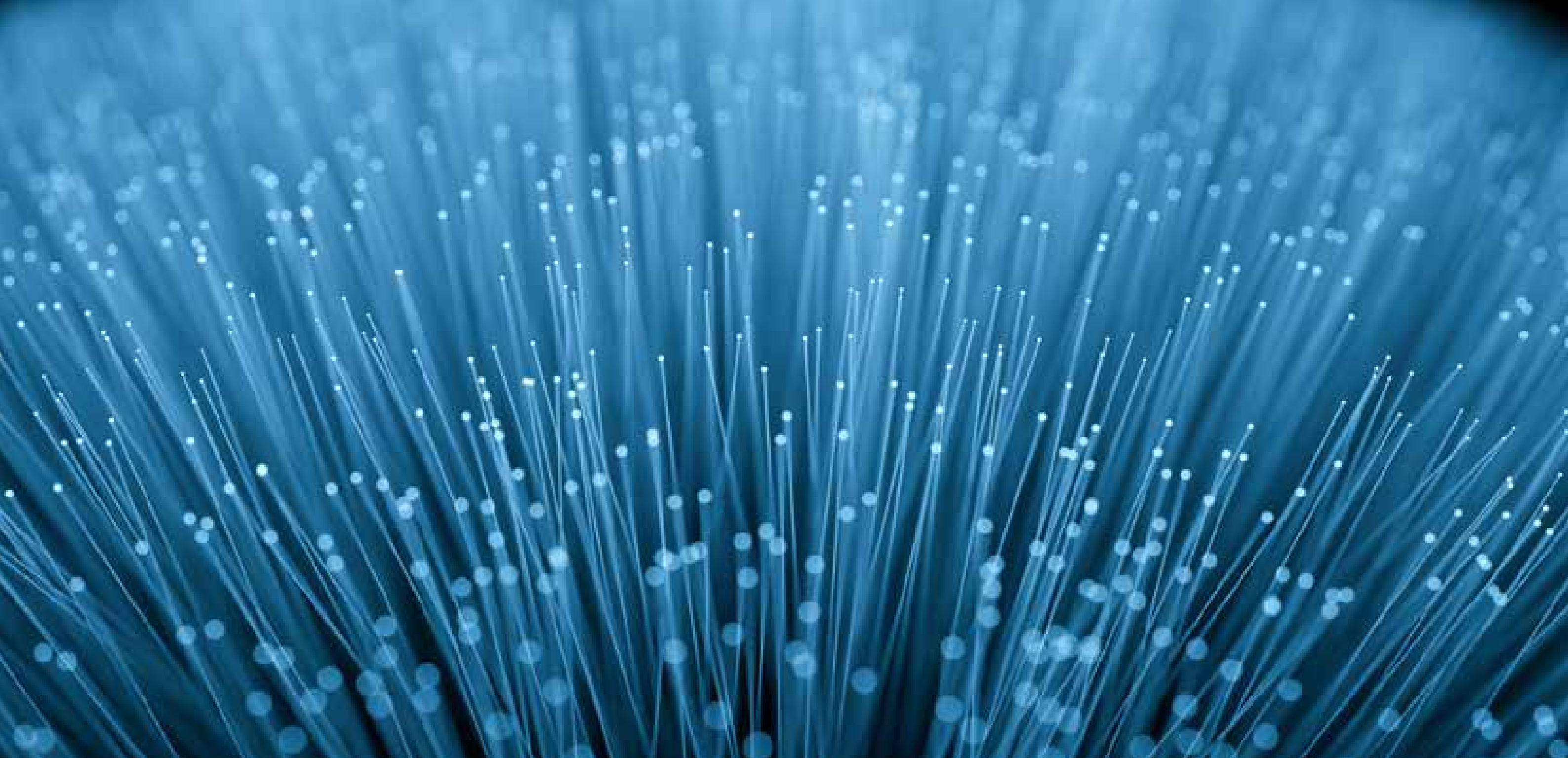
Maintenance services concerning machinery manufactured in a Special Economic Zone, provided outside the zone, should be considered activity within the zone

Ruling description

The Supreme Administrative Court in Warsaw in its judgment of August 27, 2015 (case no. II FSK 541/14) resolved that revenues obtained by a company from its maintenance services involving the repair of machinery outside the area of a Special Economic Zone (SEZ) should be exempted from income tax, and hence should be considered revenues from activities within the SEZ.

The case concerned a company holding a permit for operations within a SEZ, including the manufacture of machinery and its maintenance. Some of the maintenance services are provided by the company outside the zone due to the features, size or complex construction of machines or the impossibility to disassemble a machine for the time of its repair. Therefore, the company applied for clarification whether the revenues it achieved from the services involving the repair of machines manufactured within SEZ at the client's, i.e. outside the zone, are CIT exempted.



In its judgment the Supreme Administrative Court pointed out that the fact of holding a permit for carrying on activities within the SEZ is a key factor to determine if a given activity may be classified as an activity within the zone. The court stated that in light of the factual background of the case, one of the elements of a permit for activities within a SEZ are services of maintaining machines manufactured by a company within a SEZ zone. The permit is a comprehensive act, which determines in a final and exclusive manner what should be considered activity within the SEZ. As a result, the Supreme Administrative Court considered that in a situation where this activity must be performed outside the zone due to the complex construction or size of the machinery concerned and the permit covers maintenance services, such services performed outside the zone are also covered by the permit.

Comment

The discussed judgment complies with the recent tendency to relax fiscal policy towards entrepreneurs operating in special economic zones. For example, in one of its recent judgments the Supreme Administrative Court resolved that the sale of a product leased outside a SEZ and situated outside it at the time of the sale should also be considered an activity performed within the SEZ. This confirms the thesis that in cases connected with special economic zones, courts more frequently attempt to adjudicate in accordance with life experience and common sense and take into consideration the special nature of activities within the zone. The said tendencies of the judicial practice are positive because practice shows that sometimes activities within a SEZ cannot be limited to the area of the zone.

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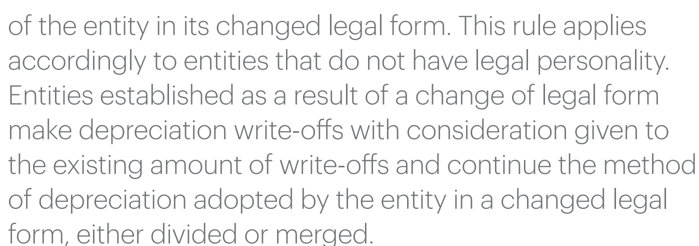
Transformation of a corporation into a partnership offers the possibility of depreciation of the components of an in-kind contribution allocated to capital surplus

Ruling description

On August 19, 2015, the Supreme Administrative Court (NSA) ruled in case ref. II FSK 1898/13 that a partner in a partnership established as a result of transformation of a corporation may include depreciation write-offs from fixed assets and intangible assets under tax deductible costs in their full value, regardless of the limitations applicable in this respect in a transformed corporation.

Comment

The ruling commented on should be met with approval. Pursuant to Art. 16 sec. 1 item 63 letter d) of the CIT Act, depreciation write-offs of the initial value of fixed assets and intangible assets acquired in the form of an in-kind contribution are not, among other things, deemed tax deductible costs in the part of their value that was not transferred to establish or increase the share capital of a corporation. Hence, this provision applies to depreciation write-offs on fixed assets acquired by a corporation in the form of an in-kind contribution. According to the general rule resulting from statutory acts on income tax, in the event of a change of legal form, the initial value of the fixed assets and intangible assets is determined at the amount of the initial value specified in the register (list)



of the entity in its changed legal form. This rule applies accordingly to entities that do not have legal personality. Entities established as a result of a change of legal form make depreciation write-offs with consideration given to the existing amount of write-offs and continue the method of depreciation adopted by the entity in a changed legal form, either divided or merged.

Therefore, in the event of depreciation, succession is limited to continuation in terms of the determination of the initial value of a fixed asset or fixed assets and intangible assets and to the method of depreciation. However, no obligation results from the provisions of law to adopt the rules limiting the possibility of classifying depreciation write-offs under tax deductible costs, including in particular, the limitations resulting from Art. 16 sec. 1 item 63 of the CIT Act. In light of the above, once a corporation has been transformed into a partnership, the partners in the latter may classify the full value of depreciation write-offs made on the initial value resulting from the register of the corporation and then adopted in the partnership as tax deductible costs.

Although the ruling commented on refers to an individual who, following the said transformation, has become a taxpayer in respect of a share in a partnership, the conclusions resulting from the decision by the NSA should also apply accordingly to a legal person that becomes a partner in a partnership in the manner referred to above.

One should hope that the NSA ruling commented on will contribute to a change in the stance taken on this issue by tax authorities, which is unfavorable to taxpayers.

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Restructuring activities in a registered partnership (Polish: spółka jawna) are subject to civil law transactions tax

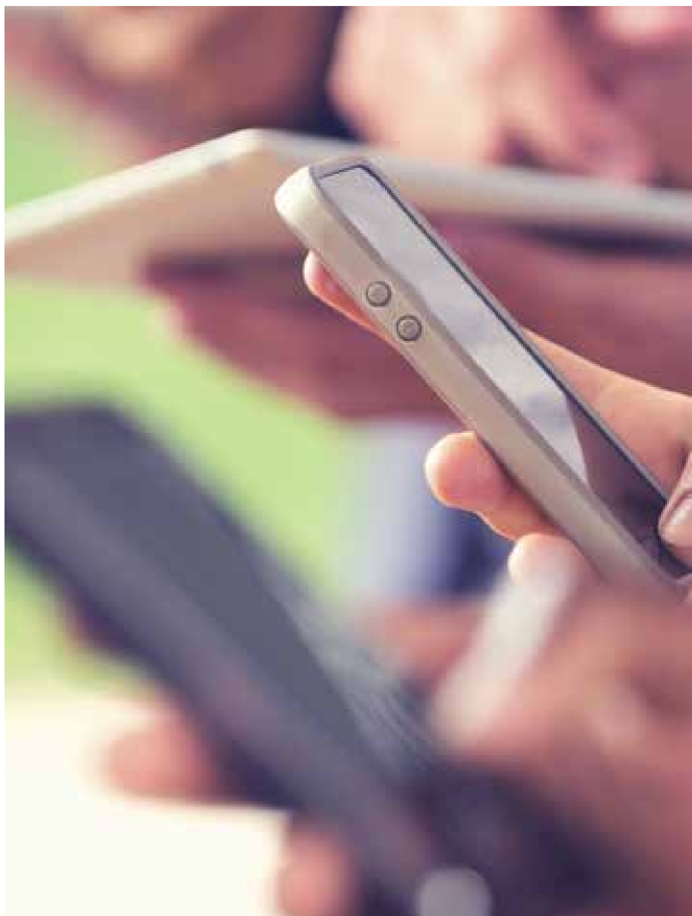
Ruling description

In the judgment of August 18, 2015 (case no. II FSK 2510/13) the Supreme Administrative Court confirmed that a registered partnership is excluded from the scope of application of the Capital Duties Directive (69/335/EEC). Therefore, Restructuring activities in such a company are subject to civil law transactions tax (PCC).

A joint stock company, as a legal successor of a registered partnership, applied for the overpayment of the PCC collected by the remitter – a notary public – in relation to the increase of a contribution to the registered partnership, covered by an in-kind contribution of shares in other companies.

According to the company, the said amendment of the articles was PCC exempted on the basis of the Capital Duties Directive (69/335/EWG). Tax authorities refused to declare an overpayment of the PCC. The Provincial Administrative Court in Rzeszów did not accede to the company's argumentation either. The case was finally submitted to the Supreme Administrative Court which dismissed the company's cassation appeal.

According to the Supreme Administrative Court, a Polish registered partnership is not a capital company in the meaning of the Capital Duties Directive (69/335/EEC). Art. 3 sec. 2 sentence 2 of the Directive provides for a Member State's right not to consider an entity a capital company. On the accession date Poland decided, on the one hand, to confirm PCC taxation of all companies, but at the same time in Art. 1a point 1 of the PCC Act it defined a separate category, namely a partnership, though previously there was no such differentiation. This allows the conclusion to be drawn that it was the legislator's explicit will to impose an indirect tax on the gathering of capital not only on capital companies and to differentiate these various organizational forms on grounds of tax law by adopting the concept of a partnership established in the Commercial Companies Code, though the directive does not use this term. In this respect it is legitimate to conclude that the Polish legislator effectively took advantage of the option of excluding partnerships (including, without limitation, a registered partnership) from the application of the Capital Duties Directive (69/335/EEC), insofar as it concerns imposition or the rules of imposing a capital tax such as the civil law transactions tax.



According to the Supreme Administrative Court, exercise by Poland of the right not to regard certain entities as capital companies does not mean that the rules of taxation of transactions listed in Art. 1, made by companies other than capital companies in the meaning of Art. 3 sec. 1 of the Capital Duties Directive (69/335/EEC), adopted in the PCC Act, may be considered discretionary.

Comment

This is another judgment confirming that restructuring activities in registered partnerships do not enjoy the same tax exemption as in the case of capital companies. The situation of partnerships, i.e. civil, registered and professional partnerships is much different, as their characteristic feature is the scope of liability of all partners, without any exceptions, and the lack of a necessary capital (shareholding) element. The exemption is applicable to limited partnerships and limited joint stock partnerships. Hence, restructuring activities in limited joint stock partnerships and limited partnerships, taxed with PCC, are worth analyzing.

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