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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 May 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,

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Compensation for uncollectible debts deprives taxpayers of their eligibility to benefit from VAT relief for bad debts

Ruling description

The Supreme Administrative Court (NSA) awarded in its judgment of May 21, 2015 (case no. I FSK 739/14 NSA) that compensation for uncollectible debts is a form of payment and that, therefore, if the taxpayer benefited from bad debts relief, it must adjust the amount of tax payable accordingly.

The company requested a written tax ruling concerning a specific VAT issue it was faced with. In its request it mentioned that it takes out bad debts insurance and that the policy it holds provides that all the insurance taker's rights with regard to the client or another third party together with all of the provided security, up to the amount of the compensation paid, transfer to the insurer by operation of the law upon payment of the compensation. The compensation covers 90% of the outstanding debt, with the remaining 10% being the company's deductible.

The company inquired about the legal situation prior to January 1, 2013, and wanted to know, firstly, whether the debts it was compensated for can still be deemed uncollectible debts subject to bad debts relief and, secondly, whether the company, having benefited from the bad debts relief and collected the compensation, must repay the tax payable in respect of the debt amount covered by the compensation.

The position of the company was that the status of uncollectible debts remains unchanged following the payment of compensation and that it continues to be entitled to the bad debts relief in respect thereof. The company held that after it benefited from the bad debts relief and received the compensation, it was not required to repay the tax payable in respect of the debt amount covered by the compensation as this compensation is not classifiable as a circumstance requiring the tax payable to be repaid, viz. a situation whereby the relevant claim was transferred or the debt settled in whatever manner.

The Ministry of Finance disagreed with the view proposed by the company, finding that payment of all or part of a debt – also by a third party, such as the insurer – excludes entitlement to the bad debts relief under Article 89a(1) of the VAT Act since the situation is that of a debt transfer. Thus, if the taxpayer had adjusted its tax payable to account for the bad debts relief, it will be required to repay the tax due in respect of the debt amount covered by the compensation.

The case was eventually remanded to the Provincial Administrative Court in Wrocław which set aside the appealed tax ruling with its judgment of January 9, 2014. The last resort (cassation) appeal filed against this judgment by the Ministry of Finance was dismissed by the

Supreme Administrative Court which found that payment of compensation is not tantamount to a debt transfer but only results in a third party taking the place of the satisfied debtor. What this leads to is a settlement of an invoiced amount and, accordingly, the part of the debt that was settled does not qualify as uncollectible debt.

Comment

Although the tax ruling issued in this case was set aside, the courts did not side with the company. The Ministry of Finance incorrectly interpreted the regulations governing the bad debts relief and failed to respond to the company's queries in a clear and comprehensible manner. The authority could not decide whether the situation at hand was a transfer or payment of the debt, alternating between these two interpretations. The trial court came up with the tenable position that payment of compensation by an insurance company constitutes a debt settlement which calls for an adjustment of the amount of the tax payable.

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Polish definition of the first occupation inconsistent with the VAT Directive

Ruling description

The Supreme Administrative Court [NSA] in its ruling of May 14, 2015, case file number: I FSK 382/14, ruled that the definition of the first occupation, as provided for in the Polish VAT Act, in terms of the condition of letting for use "in performance of taxable activities" is not legally supported by the 112 Directive. In view of the above, if a company used a real property as part of the company's business activities, the first occupation of the said real property took place within the meaning of the VAT provisions. Consequently, if a condition regarding a lapse of a particular period of time (2 years) was also satisfied, the delivery of the said real property would satisfy the premises to apply the exemption, as provided for in Article 43 section1 point 10 of the VAT Act.

Comment

Pursuant to Art. 43 section 1 point 10 of the VAT Act, delivery of buildings, structures or any part thereof is exempted from VAT, except for the following situations: if (i) the delivery is conducted as part of or before the first occupation, or (ii) if less than 2 years lapsed between the first occupation and delivery of the building, structure of any party thereof. If the delivery satisfies the conditions for applying the aforementioned exemption, the parties to the transaction may resign, pursuant to Article 43 section 10 of the VAT Act, from the said exemption and choose the said delivery to be taxed by VAT.

Whereas, pursuant to Art. 2 point 14 of the VAT Act, the first occupation shall be construed as letting for use, as performance of taxable actions, to the first buyer or user of the buildings, structures or any part thereof after their (a) construction, or (b) improvement, if the expenses incurred for the improvement constitute, within the meaning of the income tax provisions, minimum 30% of the initial value.

To date the tax authorities and administrative courts have taken the stance that the first occupation is conducted only by way of performance of actions which are subject to or are exempted from VAT, including in particular sale, contribution in-kind, lease or tenancy. Hence, the first occupation was deemed to take place the moment when a building, structure or any part thereof was let for use to the buyer, lessor, i.e. as a rule a third party.

The commented ruling refers to an option of a first occupation of a part of a building used by a taxpayer to conduct its own business activity. The NSA ruled that the Polish legislator exceeded its competences narrowing down the option of first occupation of a building, structure or a part thereof to only letting it for use in performance of activities subject to VAT which criterion is not supported by the VAT Directive. This conclusion follows from the comparison of the wording of the provisions and their linguistic interpretation as well as from the teleological interpretation thereof. Pursuant to the court rulings handed down by the Court of Justice of the European Union, first occupation, within the meaning of the VAT Directive, should be interpreted broadly and refers to a particular use of a given building. Hence, the court found that the first occupation refers also to the situation when a building, structure or a part thereof is used by a taxpayer as part of his/her business activities.

The commented ruling of the NSA is a milestone in the court rulings issued by administrative courts and may in future contribute to the change of the trading practice in this respect.

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Payments made upon the acquisition of intangible assets and legal values do not constitute royalties

Ruling description

The NSA in its ruling of May 27, 2015 (case file number: II FSK 300/15) confirmed that pursuant to double taxation treaties (hereinafter the "DTT") the term "royalties" should only apply to two types of transactions – letting for use and establishing the right to use.

The case referred to a transaction which was made in connection with the reorganization of an international corporate group, specifying partly its objective as the acquisition of non-tangible assets.

In 2011, a Polish company purchased the assets of a group company and its shareholder, namely an Austrian company limited by shares. In part the agreement referred to the so-called customer equity comprising agreements taken over by the company, the client data base, the client relations and as well as the distribution channels which constitute intangible assets.

The Company requested a confirmation, issued in the form of a tax ruling, of a method with which it should classify payments made in respect of the above transaction. In justification of its stance, the Company indicated that the revenue due to the Austrian company in respect of payment made for intangible assets in the form of agreements with clients, all of the rights and obligations under the said agreements and a clients' list, being a part of the said agreements, constitutes a profit generated by the transfer of the ownership title to any other assets, as referred to in Article 13 section 5 of the DTT and, at the same time, the profit of the enterprise, as referred to in Article 7 section 1 of the DTT, which is subject to taxation only in Austria, hence the company was not encumbered with the obligation to deduct the withholding tax.

The Minister of Finance found that the stance presented by the Company was incorrect and indicated that the amount which the company paid out to the Austrian entity constituted payment for know-how, as referred to in Art. 12 section 3 of the UPO and falls within the scope of the term: royalties. In view of the above, the company was required under the tax provisions to deduct the withholding tax applying, however, a lowered rate following from the treaty.

The Company filed an appeal against the said tax ruling with the Provincial Administrative Court in Łódź which then reversed the said tax ruling. Next, the Minister of Finance appealed against the ruling and the NSA dismissed the appeal in cassation. According to the NSA the amount paid out to the Austrian entity does not constitute payment for know-how but a profit from business activities of an enterprise (Article 7 of the DTT) or a profit from transfer of ownership title to the assets (Article 13 of the DTT) which, considering the factual status and wording of the Polish-Austrian DTT leads to the absence of the obligation to deduct withholding tax.

The Court further stressed that the regulation regarding the royalties applies only to two types of transactions: letting for use and establishing the right to use intangible assets. This is why payment for the acquisition of all such rights cannot constitute royalties.

Comment

The ruling in question confirms that concluding a cross-border transaction, it is necessary to examine in detail its nature which, depending on the royalties, has two main aspects. In order to correctly assess whether payments made as part of the considered transaction constitute royalties, it is necessary to determine both if the object of the transaction constitutes transfer of copyright, within the meaning of Article 12 of the DTT, and consider the form in which the right to use the said copyrights is transferred. As regards the latter of the two aspects, agreeing entirely with the NSA, it should be stressed that payments made for letting for use and establishing the right to use may be royalties falling within Article 12 of the DTT.

The mere fact of making payments in connection with the agreements whose subject matter includes rights attached to intangibles, does not mean that the subject matter of the agreements involves royalties.

In addition, entities concluding international transactions should pay attention to the provisions of the applicable double tax treaties. Please note that the provisions of particular agreements may vary and may have wording that is contrary to the Model OECD Convention. Undertakings concluding particularly complex commercial transactions should analyze the said provisions in detail and, if need be, filing for tax rulings.

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Debt assumption for a fee does not generate taxable revenue for the party assuming the debt

Ruling description

The Provincial Administrative Court (WSA) in Warsaw found in its ruling of May 27, 2015 (case no. III SA/Wa 3019/14) that a fee received by a company for assuming the debt of another company is not tantamount to definitive enrichment and that, accordingly, it cannot be deemed revenue in the meaning of income tax regulations.

The case concerned a company which took over a debt under a facility agreement from another taxpayer for a fee equal to the debt amount. The company held that the fee it received did not constitute taxable revenue as it intended to spend it all to repay the credit facility to the lending bank. In effect, the company did not achieve definitive enrichment adding to its assets. The tax authority was of the view that the taking over and repayment by a company of a debt under a debt assumption agreement cannot be seen as tax-neural. According to the tax authority, the assets of the company concerned were increased as a result of the debt assumption for a fee by the amount the company was entitled to receive in consideration of the debt assumption transaction.

The WSA in Warsaw disagreed with the tax authority, emphasizing that the fee the company is to receive for taking over the debt will be equal to the debt amount. It is therefore logical that if the company replaces the original debtor, thus becoming a party to the original obligation

relationship created when the credit facility was being provided, it will become obligated to repay the facility. Thus, in a situation of this kind, one cannot see the fee (remuneration) the company will receive for taking over the debt as being definitive in character, and it is for this reason that the WSA in Warsaw found that the fee due to the company cannot be classified as taxable revenue.

Comment

The ruling handed down by the WSA must be seen as sound. The prevailing view is that taxable revenue may arise when (i) the enrichment leads to an increase in the taxpayer's assets without at the same time increasing the taxpayer's liabilities, and (ii) the taxpayer's enrichment is definitive, i.e. it was not subject to repayment and was not conditional on anything. In the case at hand, the fee for taking over the debt was to be spent to repay the debt. As a result, the taxpayer did not see any effective net increase in its assets and it would therefore be hard to point to any financial benefit it received that could be subject to taxation. Also, if the tax authority's logic were to be accepted, a situation could arise whereby the taxpayer would recognize revenue upon assuming the debt for a fee but then would be unable to claim the debt repayments as tax expenses, given that the repayment of a bank credit does no entitle the taxpayer to recognize tax expenses other than interest payments. The WSA's ruling must thus be seen as correct and in line with the basic rules of income taxation.

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A Dutch investment fund organized in the form of a "cooperative" is not exempt from CIT under Art. 6 Sec. 1 Clause 10a of the CIT Act

Ruling description

The Voivodship Administrative Court in Warsaw ruled in a judgment issued on May 25, 2015 (case file no. III SA/Wa 3144/14) that Dutch funds legally organized as "cooperatives" and Polish investment funds operating under the Investment Funds Act are incomparable due to their different business objectives.

Any income generated in Poland by a foreign investment fund is exempt from taxation in Poland provided that the overseas investment fund fulfills the requirements laid down in Art. 6 (1) (10a) Clauses (a)-(f) of the CIT Act. Under Art. 6 (1) (10) (b) of the Act, collective investments of cash raised in public or private placements of participation units in securities, financial instruments and other property rights must constitute the only business objective of a foreign investment fund. A Dutch fund organized in the form of a "cooperative" may become a shareholder of a Polish company limited by shares or a Polish partnership and make business/generate profits in Poland via the company or partnership. Bearing in mind the above, the Voivodship Administrative Court agreed with the tax authority and ruled that the scope of business objectives of the Dutch fund is broader than that permitted for Polish investment funds, which are banned from investing in partnerships and do not issue securities. As a result, the Court found that the Dutch fund does not meet the criteria of comparability and therefore is ineligible for the CIT exemption.

Comment

The application and interpretation of the exemption provided for in Art. 6 (1) (10a) of the CIT Act give rise to difficulties and lead to a large number of disputes between taxpayers and tax authorities. In their rulings, the tax authorities on many occasions tend to disregard the fact that as an EU member state Poland is required to take into account prevailing EU principles when interpreting EU regulations, including the non-discrimination principle. The line of administrative courts' jurisprudence on this issue is still in the making and for this reason there are no unequivocal criteria for foreign funds' eligibility to use the exemption. For example, some courts have ruled to the effect that US-based funds qualify for the tax exemption notwithstanding the fact that US funds are generally managed in a different manner than that provided for in Art. 6 Sec. 1 Clause 10a lit f) of the CIT Act. In the context of the commented ruling, administrative courts seem to afford more privileges to funds based outside the EU/EEA than those registered in the EU, which seems to infringe upon the non-discrimination principle referred to above. The Voivodship Administrative Court in Warsaw, in the aforesaid ruling, also seems to disregard the fact that regulations in other jurisdictions may provide for a broader scope of permitted investments than those provided in the Polish Investment Funds Act and this should be without prejudice to such funds' eligibility for CIT exemptions in Poland.

This is probably the first judgment in which a Voivodship Administrative Court has addressed the possibility of a Dutch investment fund organized as a "cooperative" enjoying an income tax exemption in Poland. As the Supreme Administrative Court has not developed an unequivocal line of jurisprudence, we can only hope that administrative courts in the future will take a different, more beneficial stance on this issue.

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Succession of rights arising from tax rulings in the event of company transformations

Ruling description

The Supreme Administrative Court (NSA) confirmed in its ruling of May 27, 2015 issued in case no. II FSK 884/13 that if a company which had previously obtained a tax ruling undergoes transformation, the rights arising from the said tax ruling may transfer to the post-transformation company regardless of whether it was issued before or after July 1, 2007.

Until July 1, 2007 the Tax Ordinance contained a clearly-worded regulation whereby the protection accorded by a tax ruling extends also to the legal successor of the taxpayer which originally obtained the tax ruling. Although this regulation was repealed with effect on July 1, 2007, the general regulation in the Tax Ordinance which provides that all the rights vested in an association of capital under tax laws pass on to any new association of capital created by transforming the former continues to apply.

A joint stock company contemplating a transformation into a limited liability company requested a tax ruling confirming that the newly-created limited liability company will be eligible to the protection accorded to the joint stock company by tax rulings issued both before and after July 1, 2007.

The Director of the competent Tax Chamber agreed with the taxpayer only insofar as tax rulings issued before July 1, 2007 are concerned, but objected to the succession of rights arising from tax rulings issued after that date. The Director argued that following the repeal of the mentioned special regulation governing the succession of rights arising from tax rulings in the event of a transformation of the taxpayer, the cited general provisions of the Tax Ordinance do not provide sufficient grounds for the said succession.

Both the Provincial Administrative Court and the Supreme Administrative Court sided with the taxpayer. The two courts found that the change which took place in the legal situation on July 1, 2007 was merely technical, as it involved the repeal of a redundant special regulation applicable exclusively to succession of rights arising from tax rulings in a situation when the succession of all rights under tax laws (including the rights arising from tax rulings) was already adequately dealt with by the mentioned general regulation. The courts of both instances emphasized, further, that the view prevailing in court rulings is that effective succession of rights arising from tax rulings is conditional first and foremost on compliance therewith by the taxpayer’s legal predecessor. If that is the case, the legal successor is free to exercise the rights vested with its predecessor based on the tax rulings.

Comment

When considering the issue of universal succession, courts always assume the rule that in order for a legal successor to be eligible to the protection accorded to its

legal predecessor by the tax rulings it obtained, the tax rulings must be effectively relied on by the legal predecessor. Till now the discussions of succession focused on this circumstance and its practical implications, and only rarely dealt with the impact the amendments to the Tax Ordinance which took effect on July 1, 2007 could have on the succession of rights arising from tax rulings. The NSA ruling of May 27, 2015 considered here — favorable to taxpayers, as were the few other rulings concerning the issue — is definitely worth bearing in mind when in dispute with the tax authorities or when planning restructuration transactions. The ruling confirms that in the current legal situations post-transformation entities need not apply for new tax rulings to the tax authorities, as their safety in the sphere of taxation is guaranteed by the favorable tax rulings issued to their legal predecessors. This finding may prove important, especially if the fiscal authorities take a new course in their practice, detrimental to taxpayers, when the tax regulations remain unchanged and the entity contemplating a restructuring exercise continues to benefit from the favorable tax rulings issued before the fiscal authorities changed course.

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