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Tax Review

Dentons Poland

JULY 2015

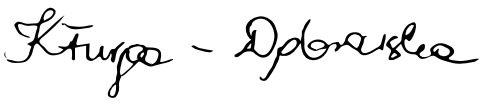
Note from the editor

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 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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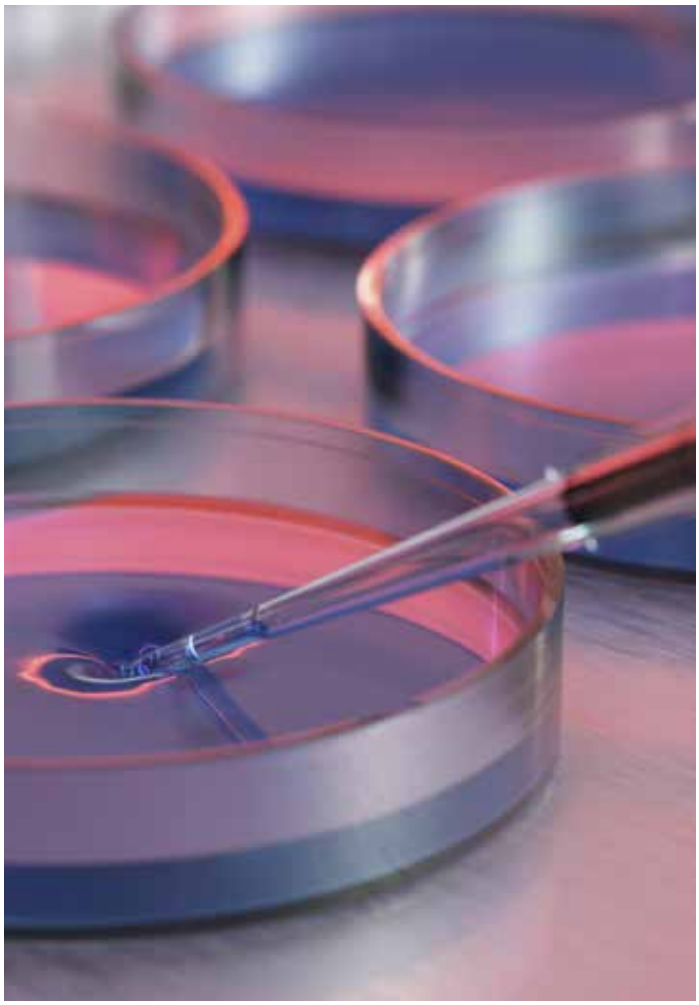
Resolution adopted by the Supreme Court sitting in a panel of 7 judges dated June 17, 2015 regarding social insurance contributions paid by members of a company management board



Ruling description

A panel of 7 judges of the Supreme Court (SN) adopted a resolution on June 17, 2015 (case file no. III UZP 2/15), worded as follows: A member of the management board of a joint-stock company who concluded a service contract with the said company for provision of management services conducted as part of his/her non-agricultural business activities is subject to social insurance on the basis of the service contract (Article 6 Section 1 Point 4 of the Act dated October 13, 1998 on the social insurance system – consolidated text: Journal of Laws of 2015, item 121).

The Supreme Court gave legal effect to the resolution and stated that the interpretation presented therein is binding as of the date of its adoption (i.e., as of June 17, 2015).

Comment

The SN supported the interpretation of provisions of the Act on Social Insurance Contribution that was presented by the Social Insurance Institution (ZUS), according to which all managerial contracts should be subject to social insurance contributions on the same terms as a mandate contract (i.e., the contribution assessment basis depends on the actual revenue obtained by a management board member on the basis of his/her managerial contract rather than the declared minimum amount from his/her business activity).

The SN had previously questioned the above approach presented by the ZUS (e.g., in the rulings dated December 9, 2008, case file number: I UK 138/08 and June 23, 2009, case file number: III UK 24/09). Nevertheless, in the ruling of November 12, 2014 (case file number: I UK 124/14), which we had previously discussed, the SN found that management board members who concluded managerial contracts should be registered with the ZUS as contracting parties regardless whether they act, in the said contracts, in the capacity of natural persons or entrepreneurs conducting their management activities. In this situation the company which employs them becomes the payer of the contributions.

In light of the aforementioned ruling and the commented resolution of 7 SN judges, and first and foremost in light of the legal force given to the said resolution, it should be concluded that the SN departed from its previous position which was beneficial to management board members. It may be expected that the rulings handed down by courts of lower instances in similar cases, including ones which refer to the previous factual status, will be consistent with the thesis presented in the resolution in question.

A practical consequence of handing down the resolution in question is the fact that the company's (payer's) duty to register management board members with whom the company has signed managerial contracts (even

if the services are provided as part of the business activities of the said members), for the purposes of social insurance, has already been determined. Consequently, our recommendation would be to consider changing the currently adopted approach in terms of contributions paid from managerial contracts, verify future settlements and assess possible risk.

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Tests for having a fixed establishment in Poland for VAT purposes

Ruling description

The Provincial Administrative Court in a ruling of June 15, 2015 (case file number: III SA/Wa 3332/14) found that a taxpayer should have a fixed establishment in Poland if it rents a warehouse in Poland and benefits in Poland from services such as office support, translation services etc.

Pursuant to Article 28b of the VAT Act, the place of providing services, in terms of the services provided to a taxpayer, is the place where the taxpayer, as recipient of the services, has established its business. If the services are provided for a taxpayer's fixed establishment, which is located in a different place than the taxpayer's place of establishment of its business, the fixed establishment is the place where the said services are provided. Hence, in order to determine whether the services provided to a foreign taxpayer by Polish contractors are subject to VAT in Poland, it is necessary to determine whether a foreign taxpayer has a fixed establishment in Poland.

The VAT provisions and regulations provide no definition of a fixed establishment. This is an EU term which follows from the Sixth Council Directive 77/388/EEC and Council Directive 2006/112/EC. The term "fixed establishment" was also explained in the Council Implementing Regulation no. 282/2011 which established implementation measures for Directive 2006/112/EC on the common system of value added tax. Pursuant to Article 11 Section 1 of the Implementing Regulation, for the purposes of application of Article 44 of Directive 2006/112/EC, "a fixed establishment" means any place, other than the taxpayer's place of establishment of a business, which is characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to receive and use the services supplied to it for its own needs. Whereas, pursuant to Article 11 Section 2 of the Implementing

Regulation, "a fixed establishment" means any place other than the place of establishment of a business which is characterized by a sufficient degree of permanence and a suitable structure in terms of human and technical resources to enable it to provide the services which it supplies.

Pursuant to the aforementioned regulations, the Minister of Finance and, subsequently, the Provincial Administrative Court in Warsaw found that it is not necessary to engage one's own technical and personal resources in order for there to be a fixed establishment within the meaning of Article 44 of the 112 Directive. It is sufficient if a company uses the resources provided by another entity. Both the court and the tax authority found that the Finnish company (a boat manufacturer) which rents a warehouse in Poland and benefits in Poland from office support services, translation services, etc. does have certain resources and acquires a certain set of auxiliary services which may be deemed as characteristic for running a fixed establishment. Consequently, the services which the Polish contractors provide to the Finnish entity are subject to VAT in Poland..

Comment

The ruling handed down by the Provincial Administrative Court in Warsaw merits a negative assessment. In the discussed matter, the court analyzed only part of the tests which must be satisfied in order to determine whether a taxpayer established in a foreign country a fixed establishment for VAT purposes. As follows from the court rulings handed down by the Court of Justice of the European Union, it is not necessary to maintain one's own personal and technical resources in a foreign country in order to have a fixed establishment (e.g. rulings case file numbers: C-260/95 DFDS and C-605/12 Welmory). This means that a foreign entity which subcontracts certain functions to a contractor in Poland may be deemed to be an entity with a fixed establishment in Poland. The condition, however, is that the said foreign entity should be entitled to similar control over the human and technical resources of its contractor as it has over its own resources. The Provincial Administrative Court failed to consider this question in the analyzed resolution. One may only trust that, at the next stage of the proceedings, the Supreme Administrative Court will correctly consider all the circumstances. We recommend that clients which receive services from subcontractors other than in the country which hosts the place of establishment of their business observe the practice of the tax authorities in terms of a fixed establishment for VAT purposes.

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The timing of income in connection with participation in employee incentive programs organized by an overseas company

Ruling description

The Voivodship Administrative Court in Warsaw, in a judgment dated June 12, 2015 (case file no. III SA/Wa 3043/14) ruled that income on account of participation in employee incentive programs arises upon the disposal of shares allotted to the employee, not at the time the employee exercises rights under the option scheme, or in simple words, obtains the shares to which s/he is entitled under the scheme.

The taxpayer worked for a Polish limited liability company ("PolCo"), which is part of an international capital group and has participated in an option scheme ("Program") operated by the German-based ultimate parent company ("DECo"). All Program participants were granted a free-of-charge non-transferrable, conditional right to prospectively acquire DECo shares free of charge and to acquire free of charge one additional share for each three additional shares purchased by the employee. The right to acquire (subscribe for) DECo shares arose from resolutions adopted by the General Meeting of DECo.

To ascertain tax liabilities ensuing from Program participation, an employee applied for an individual tax ruling to confirm that by exercising the conditional right, i.e. acquiring the shares, the taxpayer does not per se earn any taxable income.

According to the taxpayer, he will only generate income on account of Program participation upon disposal of the shares (rather than allocation), and the prospective income ought to be treated as 'cash equity income' (dochód z kapitałów pieniężnych). The taxpayer cited Art. 24 Sec. 11 of the PIT Act, which stipulates that income representing the difference between the market value subscribed for by persons eligible to do so under the terms of a General Meeting resolution and the expenses incurred to subscribe for them is not taxable at the time of share subscription.

The tax office ruled that the taxpayer's submissions were incorrect and that the taxpayer ought to report income on two occasions, i.e. not only upon the disposal of the shares subscribed, but also at the time the employee exercises rights under the Program and acquires DECo shares free of charge. According to the tax authorities, the acquisition of shares by the taxpayer under the Program is not subject to the tax exemption cited by him, as the shares had not been acquired pursuant to a General Meeting resolution, but DECo's commitment under the Program. The resolution of the General Meeting of the German company provided for the taxpayer's right to acquire (subscribe for) shares in a German company, not the acquisition of DECo shares.

In setting aside the tax ruling on appeal, the Voivodship Court ruled that the exemption under Art. 24 Sec. 11 of the PIT Act, also applies to foreign companies limited by shares domiciled in other EU or EEA member states and does not constitute a definitive tax exemption but merely postpones the timing of the tax liability in connection with the acquisition of shares to the moment they are disposed of. The Court also held that considering that the Company submitted that the shares had been allocated under the terms of a Program approved by a resolution of DECo shareholders, the exemption may be applied to shares subscribed for and acquired under the Program.

Comment

The commented judgment seems to be in line with the line of administration of justice by administrative courts. That said, in some cases, the tax administration insists that shares allocated to employees under incentive schemes ought to be taxed twice: upon the free-of-charge acquisition of shares (on account of a free-of-charge benefit earned by the employee), and again upon the sale of the shares by the employees. We find this approach unacceptable.

Undoubtedly, the Voivodship Administrative Court was right in pointing out that the taxpayer's rights would have been infringed if the exemption under Art. 24 Sec. 11 of the PIT Act had not applied. We concur with the Court's conclusion to the effect that the tax exemption also needs to apply to shares acquired under an incentive scheme, considering that the scheme had been approved by a General Meeting resolution. Although tax exemptions must not be interpreted expansively, we cannot agree with an opposite situation, where the exemptions are interpreted so narrowly as to deny taxpayers the rights they are eligible to.

Additionally, it must be pointed out that if we were to agree with the stance taken by the tax office, we would undermine the purpose of the regulation at issue, i.e. to avoid double taxation (of free-of-charge share acquisition and the subsequent sale of the shares) of the taxpayer on account of only one benefit obtained. For this reason, we support the Court's determination, as it seems to have duly ruled that the deferment of taxation in time enables the taxpayer to avoid double taxation while at the same time not leading to tax evasion per se. The ultimate benefit is earned upon the sale of the shares and for this reason the taxable income needs to be assessed at that point in time.

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Defective decisions irreversible after five years

Ruling description

In its ruling of 1 June 2015, case no. I FSK 1994/13, the Supreme Administrative Court (NSA) ruled that the statute of limitations in tax law is not only intended to protect the taxpayer but is also aimed at providing for the stability of tax relationships. As a consequence, upon the lapse of the time-barred period, a decision cannot be reversed even if it leads to the consolidation of errors made by tax authorities.

As a result of an inspection, in his decision of December 2009, the Head of the Tax Inspection Office defined the VAT tax liability for the period from May 2004 through December 2004 as a result of challenging the taxpayer's right to apply the 0% VAT rate in the exports of goods. A penal fiscal proceeding was instituted against the taxpayer in order to suspend the period of time-barring a tax liability. Namely, as stipulated in Article 70 § 6 clause 1 of the Tax Ordinance, the course of the limitation period for a tax obligation shall not commence and, if commenced, it shall be suspended as of the day of initiating proceedings in matters of a revenue offence or revenue petty offence provided that the suspicion of the offence or petty offence is linked with a failure to perform such obligation.

Upon considering an appeal, in March 2010 the Director of the Tax Chamber sustained the decision of the first instance. An appeal against that decision was dismissed by the Voivoship Administrative Court in Białystok.

Subsequently, the Supreme Administrative Court did not find any basis to repeal the ruling of the court of the first instance.

In his application of August 2012, the taxpayer moved for the proceeding concluded with the March 2010 decision to be reopened on the basis of the Constitutional Tribunal ruling of 17 July 2012, case no. P 30/11, in which the Tribunal held that Article 70 § 6 clause 1 of the Tax Ordinance was inconsistent with the Constitution to the extent it results in the suspension of the course of the limitation period for a tax obligation in connection with the institution of penal proceedings or proceedings in matters of a revenue offence or revenue petty offence, of which offence the taxpayer has not been informed by the lapse of the time period indicated in that provision, at the latest.

The taxpayer claimed that he was not duly notified of the penal fiscal proceeding and, consequently, the course of the limitation period for the 2004 tax obligation was not suspended in his case. In view of the fact that tax authorities are obligated to observe the limitation periods for tax obligations ex officio, it should be assumed that the original decision that defined the tax obligation had already been handed down in breach of the law. Due to the lapse of the period of limitation for the tax obligation, the Director of the Tax Chamber should have issued a decision to discontinue tax proceedings in respect of the tax obligation for the periods from May 2004 through November 2004 in 2010 already.

The Director of the Tax Chamber reopened the proceeding but refused to set aside the decision due to the lack of the possibility to rule on the case as a result of the lapse of the period of limitation for the tax obligations from settlement periods covered by the decision pursuant to Article 245 § 1 clause 3 letter b of the Tax Ordinance. Pursuant to that provision, a tax authority hands down a decision whereby it refuses to set aside the entire part or any portion of the existing decision if it finds that there are grounds for reopening the proceedings but a new decision as to the merits or the case cannot be handed down due to the lapse of the periods of limitation.

The Voivoship Administrative Court in Białystok shared the taxpayer's position that the March 2010 decision had to be set aside. In the Court's view, the provision of Article 245 § 1 clause 3 letter b of the Tax Ordinance does not prevent the tax authority from setting aside, upon reopening the proceedings, the final decision that determines or defines the amount of tax obligation and discontinuing the proceedings in the case in question, despite the lapse of the period of limitation. The regulation is intended as a protective measure for the taxpayer.

However, the NSA set aside a favorable ruling of the court of the first instance. In the opinion of the NSA, time-barring is not solely a measure to protect the taxpayer but is also aimed providing for the stability of tax relationships. Hence, if a time period of limitation elapsed, then the authority is deprived of its decision-making power and should not rule on the case in either the regular or extraordinary course of proceedings. In such manner, the decision handed down by the Head of the Tax Inspection Office was sustained.

Comment

It is hard to approve the theses of the court ruling at hand, and, in particular, the thesis regarding the absolute petrification of tax relationships upon the lapse of the period of limitation. Namely, it is inconsistent with the literal wording of Article 245 § 1 clause 3 letter b of the Tax Ordinance, which does not prevent the issuance of a decision to discontinue the proceeding (it is not a decision which rules on the merits of the case). Additionally, it involves the risk of tax authorities sanctioning the violations of law and, as a consequence, violating the supreme principle of the rule of law. More importantly, it renders it difficult for a taxpayer to assert the redress of damage since it entrusts a civil law court with the assessment of premises for reparations.

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