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Tax Review

Dentons Poland

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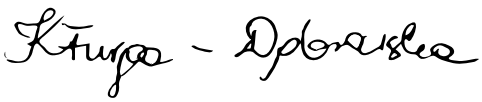
Note from the editor

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 October 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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On June 25, 2015 the Director of the Tax Chamber in Katowice issued a tax ruling (ref. no. IPTPB3/4510-103/15-4/PM) holding that the concept of 'loan' on the grounds of CFC regulation must be construed broadly, to include any transaction involving transfers of capital that must be returned with interest.

'Controlled foreign corporation' (CFC) is defined in the tax regulations in force as of January 1, 2015 as a corporation which, in addition to meeting several other criteria set out in statutory law, generates at least 50% of its revenue in the given tax year from sources listed in the applicable statutory law, including "interest and proceeds from loans of whatever kind".

The case prompting the interpretation concerned a Polish taxpayer holding a stake in a Cypriot company which reported revenue from, among other things, financial operations, including interest from a variety of deposits (such as overnight bank deposits. This revenue may have accounted for more than 50% of the Cypriot company's revenue which would make the company a controlled foreign corporation ?), as it also met the other statutory criteria for recognizing it as such. The Polish taxpayer applied for a tax ruling to confirm that the concept of 'loan' on the grounds of CFC regulations does not extend to cover bank deposits.

The Director of the Tax Chamber in Katowice disagreed, finding, in particular, that the broad construal of the concept of 'loan' in the above sense is suggested not only by its interpretation in the OECD Model Convention Commentary but also by the fact that Polish statutory law applies to "loans of whatever kind".

Comment

The tax ruling at issue marks a shift towards a more restrictive application of the CFC regulations, apparent also in the tax ruling by the Director of the Tax Chamber in Łódź dated June 18, 2015 (ref. no. IPTPB3/4510-101/15-2/IR) in which disbursements of income achieved by an investment fund and disbursements of the fund's profits from a transfer of its deposits were classified as passive revenue in the meaning of the CFC regulations. This approach leaves taxpayers with relatively little space to

adapt to the new regulations, although, in fairness, some other interpretations are advantageous to taxpayers in some of the areas covered by CFC regulations, as is the case, for example, of the definition of actual business activity as applicable to investment funds or the notion of taxation conditions that are more advantageous than those provided for by Polish laws.

This restrictive approach by fiscal authorities has already been backed by some court rulings concerning CFCs against taxpayers. One example here is the judgment of the Provincial Administrative Court in Bydgoszcz of October 20, 2015 (case no. I SA/Bd 622/15) in which the Court found that a Cypriot company in which an investment fund holds a stake may be a CFC of a Polish taxpayer holding investment certificates issued by the fund. Similar positions had also been taken by the tax authorities, to mention but the tax ruling of July 3, 2015 issued by the Director of the Tax Chamber in Łódź (ref. no. IPTPB2/4511-175/15-4/KR) or the tax ruling of the Director of the Tax Chamber in Warsaw dated February 18, 2015 (ref. no. IPPB2/415-900/14-3/AS).

Polish taxpayers operating internationally are therefore advised to exercise far-reaching caution when appraising the effects of their operations through foreign corporate structures and take prompt action to restructure them, if necessary, to avoid the risk of revenue achieved by their foreign component being taxed in Poland based on CFC regulations. Otherwise, in the present environment, taxpayers appear to stand little chance of succeeding in tax proceedings or of successfully arguing their case in courts.

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Court of Justice of the European Union specified in detail the standards of diligence which influence the right to deduct the VAT

Ruling description

Court of Justice of the European Union (CJEU) in its ruling of October 22, 2015 specified in detail the standards of diligence which influence the right to deduct the VAT

A partnership conducted a number of purchase transactions of diesel oil used for business activity and deducted the input VAT on the purchase of the fuel. A tax authority after a tax inspection refused the Company's right to deduct VAT because the invoices regarding the sale of fuel were issued by a non-existent entity. In particular it was determined that the said entity was not registered for VAT purposes, files no tax returns and pays no taxes, does not report its annual financial statements and has no license to trade in liquid fuel. In addition, the real property indicated in the commercial register as the registered office was devastated to the extent which made it impossible to conduct any business there and it was impossible to contact the said entity or the person recorded in the register as the President thereof. In addition the court of first instance found while dismissing the complaint that the Company failed to prove that it had exercised due diligence since it had failed to make sure that the transactions were not linked to the perpetration of any crime. The Company, in its final appeal filed with the Supreme Administrative Court (NSA), stated that it acted in good faith, i.e. received the documents from the contractor confirming that it was a legally operating entity (i.e. copy of the commercial register and certificates of NIP and REGON numbers). The NSA resolved to ask the Court of Justice of the European Union questions referred for preliminary rulings: whether in the case at hand supply of goods occurred and whether pursuant to 6th Directive it is legal to deprive a taxpayer of its right to deduct tax if the entity which was not the actual supplier of goods issued the invoice and it is not possible to determine the actual supplier of goods and order it to pay the tax, or it is not possible to determine the person responsible for the issuance of the invoice.

CJEU stressed that the substantive conditions of the right to deduct the input tax have been satisfied in the case at hand, namely the status of the taxpayer, the goods or services are to be used by the taxpayer at a later stage of the transaction for the purposes of its own taxable transactions and the said goods or services are to be delivered by another taxpayer placed at an earlier stage of the transaction. Formal premises justifying the right to deduct the VAT have also been satisfied, namely the taxpayer had the invoice including, among others, the VAT tax identification number of the supplier, the full name or first name and surname and address of the taxpayer and the quantity and type of the supplied goods.

In the opinion of the CJEU, the existence of a supplier or its right to issue invoices do not constitute premises justifying the right to deduct VAT. Consequently, the Company is entitled to deduct VAT even if the supplier is a taxpayer which was not registered for VAT, insofar as the invoices regarding the supplied goods include all information required by law.

A possible absence of the supplier's right to legally dispose of goods cannot rule out the supply of the said goods, insofar as the said goods were actually delivered to the Company which used to them for the purposes of the taxed transactions. In addition the question whether the supplier paid the VAT due on the transaction to the tax collector or not has no influence on the taxpayer's right to deduct the input VAT.

The tax authorities cannot in a general manner require the taxpayer to examine whether the entity issuing an invoice for goods or services to which deduction is to refer, has particular goods and is able to provide them and whether it satisfies the obligation to file tax returns and pays the VAT in order to make sure that the entities operating at earlier stages of the transaction do not commit irregularities or offences or that a given taxpayer was in possession of documents confirming any such state of affairs.

Comment

It is another important ruling handed down by the CJEU presenting a list of entrepreneurs' good practices making it impossible for the tax authorities to question the right to a VAT deduction. The Polish tax authorities do not have effective methods to fight fiscal crime and it is often the case that all transaction participants are punished, including the honest entrepreneurs. The ruling unambiguously condemns this practice. Thus, if material and formal premises of the right of deduction are satisfied and the taxpayer did not know and could not have known that a supplier, as part of a particular transaction, committed a crime or that another transaction being part of the supply chain, whether earlier or later compared to the one which the said taxpayer performed, was carried out in breach of the VAT regulations, the taxpayer cannot be deprived of the right to a tax deduction. This ruling is significant for all pending cases and may constitute grounds to reopen proceedings which ended with negative resolution handed down by the tax authorities.

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In-kind contributions of enterprises vs. succession of rights and obligations on the grounds of VAT regulations

Ruling description

On October 21, 2015 the Supreme Administrative Court handed down a judgment in case no. I FSK 1459/14 finding that a company which acquired an enterprise and continues to run it may benefit from the rights vested with the entity it acquired the enterprise from.

The case considered by the Court concerned a company which in 2011 acquired an enterprise owned by a natural person in the form of a non-monetary contribution. The enterprise comprised, among other things, vehicles used by the natural person under an operating lease agreement for the use of vehicles officially classified as lorries, meeting the conditions set out in Article 6(1) of the Act of December 16, 2010 and Amendments to the VAT Act and the Road Transport Act. The natural person at issue registered the lease agreement with the competent tax office, thus acquiring the right to the full VAT deductions for the vehicles, in accordance with the rules in place in 2010 and on condition that the lease agreement will not change. The natural person thus deducted 100% of the VAT shown on the lease invoices, without applying the 60% ceiling on VAT deductions introduced with subsequently promulgated regulations.

Upon acquiring the enterprise, the company assumed the rights and obligations under the lease agreement, to which the lessor consented in writing. The company applied for a tax ruling to confirm that it may deduct all of the VAT shown on invoices issued by the leasing company under the mentioned lease agreement. The Director of the Tax Chamber found against the company, arguing that an in-kind contribution of an enterprise to a company being a legal person triggers an amendment of the agreement made with the lessor. The Provincial Administrative Court in Warsaw also disagreed with the position proposed by the company, adding that there can be no tax succession in this case as there is nothing in the Tax Ordinance to suggest that a company, once it acquires an enterprise from a natural person, has the right to continue deducting the VAT shown in the lease invoices as the natural person was entitled to do.

The Supreme Administrative Court disagreed with the position taken by the Provincial Administrative Court in Warsaw and set aside the judgment of this trial court and the tax ruling issued by the tax authority. The Supreme Administrative Court emphasized that specific solutions are provided for in the VAT Act of March 11, 2004 in addition to the general rules of tax succession regulating the rights and obligations of legal successors in cases when an enterprise is transferred to a company as an in-kind contribution. Therefore, a taxpayer that acquires an enterprise and continues to run it may benefit from the right to deduct VAT originally vested with the seller of the enterprise. The provisions of the VAT Act and Directive 2006/112/EU are specific regulations and thus take precedence over the provisions of the Tax Ordinance.

Comment

The judgment of the Supreme Administrative Court confirms that the rules of VAT deduction applicable to the seller of an enterprise pass to the entity acquiring the business. While the judgment concerns a specific case and the rules for deducting VAT shown on leasing invoices, the conclusions drawn by the Court may be

seen as having a universal character and may impact other rulings. One consequence of assuming that the entity acquiring an enterprise may benefit from the VAT deduction rights enjoyed by the seller of the enterprise is that the acquiring entity has the right to deduct the VAT shown on invoices made out to the seller without having to correct the invoices. Till now, the Supreme Administrative Court was of the view that entities acquiring an enterprise may not deduct the VAT shown on invoices issued to the seller of the enterprise (cf. e.g. the judgment of March 21, 2012 in case no. I FSK 806/11). It remains to hope that the judgment considered here will lead to a change in this position. We recommend that our clients proceed as before and monitor developments for any changes in the approach of administrative courts to the issue.

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Virtual currency (bitcoin) exchanges for traditional currencies are VAT-exempt

Ruling description

The Court of Justice of the European Unio (CJEU) ruled on October 22, 2015 in case C-264/14 that transactions to exchange bitcoins for traditional currencies, in the meaning of Council Directive 2006/112/EU (the "VAT Directive"), are tantamount to financial services and as such are VAT-exempt.

The judgment came in connection with a case brought by a Swedish national who wished to run a business exchanging bitcoins (a virtual currency which is not issued by any single issuer but created directly online using a special algorithm) via a dedicated website. To this end he applied to the Swedish Revenue Law Commission, the country's authority responsible for interpreting tax laws, for a ruling on the manner of taxation of the proposed business activity. The Commission found transactions to exchange bitcoins for traditional currencies to be exempt from VAT, but the Swedish Tax Authority appealed against this interpretation to Sweden's Supreme Administrative Court which in turn requested the CJEU to provide an interpretation of the VAT Directive in the context of the case brought before it.

In its judgment the CJEU held that the sole purpose of bitcoins is, without a doubt, to serve as a means of payment. Consequently, the CJEU found that the service of exchanging traditional currencies for bitcoins (and vice versa) for consideration (the margin here being the difference between the currency's buying and selling prices) constitutes a financial service subject to the VAT exemption granted under the VAT Directive to transactions involving currencies, banknotes and coins used as legal tender.

Comment

The first thing to mention is that some European Union countries recognized the exchange of bitcoins for real money as a service akin to financial services already before the CJEU handed down the judgment considered here. Others, including Poland (but also Germany and Estonia), saw this activity as subject to VAT. The view prevailing in Poland, upheld by the tax authorities and the Ministry of Finance, is that this form of trade is subject to 23% VAT, being a service provided electronically.

The discussed judgment of the CJEU in which bitcoin exchange services were classified as financial services puts the bitcoin on a par with other currencies. One must agree that since bitcoins are in fact used as a means of payment, the transactions to exchange them must be seen as currency transactions and cannot be deemed services subject to VAT in the meaning of the VAT Directive.

In many countries bitcoins remain to be recognized as legal tender accepted on the grounds of these countries' legal systems, which is a precondition for eligibility to VAT exemption. It appears, however, that the conclusions drawn by the CJEU in its judgment are correct and that transactions involving non-traditional currencies (such as bitcoins) – considered to be legal tender in one or more EU member states – are in fact financial transactions exempt from VAT also in those countries which are yet to unequivocally accept them as legal tender. The approval of the bitcoins' payment function by the CJEU and acknowledgment of their VAT exemption will no doubt make it easier for business partners to settle their accounts using this currency and help spread the use of bitcoins in the future. That said, a development of this kind may give rise to practical problems which will have to be tackled at some point.

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