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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 July 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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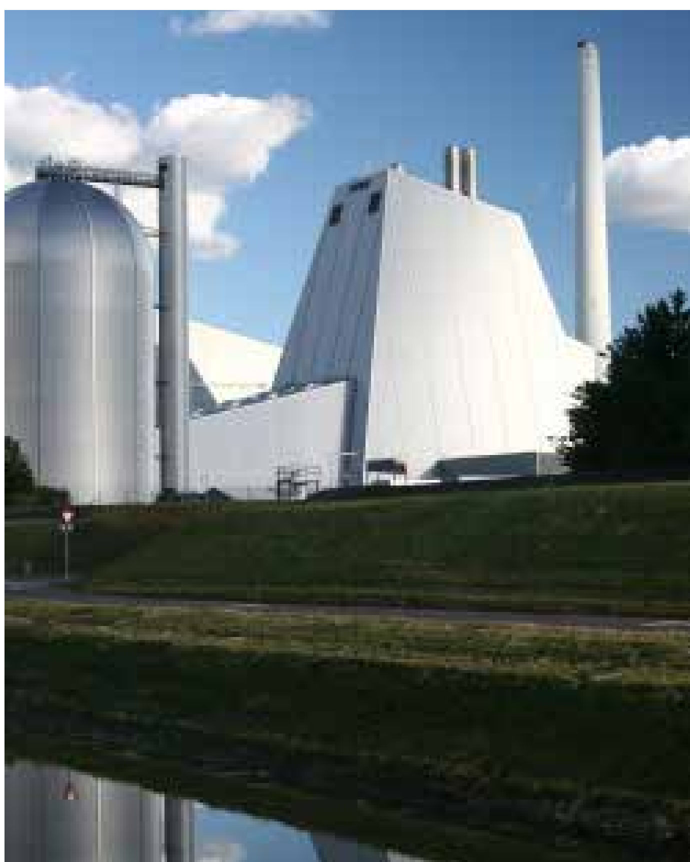
Managing a foreign fund in a manner that differs from the Polish model does not preclude the right to a CIT exemption in Poland for the income of a foreign investment fund



Ruling description

In its award of 24 July 2015, case no. II FSK 1455/13, the Supreme Administrative Court stated that the CIT exemption for the income of foreign funds is in place even when the fund is managed by a manager, i.e. an investment firm authorized to manage the fund's assets and make statements of will on behalf of the fund.

A private investment fund headquartered in Cyprus (the "Fund") applied for a tax ruling regarding the right to a CIT exemption. Pursuant to the provisions of Art. 6 (1) point 10a of the CIT Law, collective investment institutions with their registered office in a Member State of the European Union other than the Republic of Poland or in another Member State of the European Economic Area are exempted from the corporate income tax if, without limitation, they are managed by entities that operate on the basis of a permission issued by the competent financial market supervision authorities in the state where their registered office is located (Art. 6 (1) point 10a letter f of the CIT Law).

Specifically, the Fund was seeking confirmation that in the event that the management of a fund is entrusted to

a manager, i.e. an investment firm with legal status, the premise for the exemption referred to in Art. 6 (1) point 10a letter f of the CIT Law would be fulfilled.

The Head of the Fiscal Chamber in Warsaw pronounced the Fund's position to be incorrect. In the Chamber's view, the scope of an investment firm's management is narrower than the fund management referred to in Art. 6 (1) point 10 letter f of the CIT Law. The Provincial Administrative Court in Warsaw upheld the unfavorable tax ruling on the above-specified provisions. In the Court's opinion, the decisive factor involved the fact that the powers of the company managing investment activity (Invest Manager) overlapped with the powers vested in the management board of a capital company as the body authorized to manage the company's affairs and represent the company externally. The Supreme Administrative Court did not share the opinion and set aside both the award and the tax ruling. It emphasized that when an invest manager is authorized to act on behalf of the fund, then one cannot state that the manager's powers are limited to the management of investment funds only. Additionally, one cannot compel the Fund to be organized and operate in exactly the same manner as Polish investment funds. As a consequence, the Fund has the right to a CIT exemption.

Comment

JIt is one of the first favorable awards of the Supreme Administrative Court that corroborates the possibility of applying a CIT exemption to income generated by a foreign investment fund.

After the day on which Art. 6 (1) point 10a of the CIT Law took effect, the tax authorities frequently refused to issue a tax ruling or acknowledge tax overpayment acting based on the assumption that foreign funds operate in other conditions than Polish funds and it is not possible to fulfill the premises contained in the provision at hand. Harmonized funds of the UCITS type were an exception of a kind. Owing to the award, there is a chance for a change in that practice so that a larger number of funds (including also alternative investment funds and Luxembourg funds in the form of SICAV) may enjoy the tax exemption. Hence, it is worth considering filing an application for an individual tax ruling or the acknowledgement of a tax overpayment.

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Principles of revenue and tax deductible costs adjustment made in connection with issued/received correction invoices

Ruling description

The Provincial Administrative Court in Gliwice in its rulings of July 15, 2015 (case file number I SA/Gl 112/15, I SA/Gl 113/15) ruled that, if a company issues invoices to its contractors at the time it accepts their orders and, consequently, on the basis of provisions of a framework agreement and following arrangements made between the parties, the company increases or decreases the price for the sold goods, and hence issues correction invoices, the said invoices should refer to the original invoices making it impossible to settle them "on an ongoing basis". The same principle should refer to invoices received by the company and then corrected by its contractors. In view of the above, the company should retroactively adjust both revenue and tax deductible costs.

Comment

Provisions of the Personal Income Tax Act and Corporate Income Tax Act do not specify when the taxpayer should adjust revenue or costs in connection with received or issued correction invoices. At present, the stance presented by the tax authorities is that a correction invoice issued as a result of a circumstance which occurred following a sale or purchase does not evidence a separate, independent economic event but refers only to the status which existed in the past, hence to

the original invoice. Consequently, subsequent issuance of a correction invoice (or any other document) does not result in a change of the date when the revenue or cost arose but influences only the amount of the said revenue or cost. This means that the taxpayer is required to adjust revenue and tax deductible cost on the date when the said revenue and tax deductible cost arose. The Provincial Administrative Court in Gliwice also expressed this view in the commented ruling.

Nevertheless, starting from January 1, 2016 the above stance should be changed substantially. The Act of July 24, 2015 on Amendment of Certain Acts in Connection with Supporting Amicable Methods of Dispute Resolution introduces certain regulations regarding the time of adjusting revenue and tax deductible costs taking into account the reason for the said adjustment. The new provisions introduce a principle that, if an original invoice correctly evidenced a given economic event and a correction invoice was issued by the seller as a result of the subsequently occurring circumstances, e.g. reduction of price, granted discount, return of goods or guarantee/warranty, entrepreneurs would settle the correction invoice in a given settlement period (i.e. on the date when the correction invoice was issued or received). If, however, the original invoice contained errors, hence erroneously evidence the facts, the entrepreneur would have to be required to assign the correction to the date when the due revenue occurred (respectively, the date when the cost was incurred), as it follows from the original document. The provisions regarding corrections of tax deductible costs will apply accordingly to adjustments of depreciation write-offs.

The proposed changes should be perceived as favorable. In general they would allow the elimination of a number of difficulties encountered by entrepreneurs and connected with, for example, the need to correct tax returns from previous years and pay outstanding tax liabilities in this respect, including default interest (in the event of reduced tax deductible costs or increased revenue) or the need to pay interest on advance payments for income tax (in the event of reduced tax deductible costs or increased revenue in the same tax year).

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Civil law transactions tax consequences of the sale of receivables due from a Polish company by a foreign company to a Polish taxpayer

Ruling description

The Provincial Administrative Court in Łódź in its judgment of July 16, 2015 (case no. I SA/Łd 517/15) resolved that due to the fact that the Act on the Civil Law Transactions Tax does not contain any definition of a "place of exercise of property rights" it should be assumed in the case of cash receivables that this term is equivalent to the "place of performance" in the meaning of Art. 454 of the Civil Code (hereinafter: "k.c."). In the discussed case the cash receivables acquired by a Polish tax resident as a should be repaid to the hands of a assignor (company seated abroad) i.e. abroad. The fact that after the assignment the Polish debtor becomes obligated to pay the receivables to the hands of the taxpayer residing in Poland does not affect the assessment of the tax effects of the assignment of receivables in light of the civil law transactions tax (hereinafter "PCC"). In this case, at the time of concluding the agreement for the sale of the receivables, the object of the sale shall be the property rights, with the place of performance being abroad. Therefore, the said transaction is not subject to PCC if the sale agreement is concluded abroad.

Comment

The commented judgment is particularly important for entrepreneurs acquiring receivables due from Polish entities. Generally, the sale of receivables due from Polish entities may be subject to 1% PCC if these receivables constitute (i) property rights exercised in Poland or (ii) property rights exercised abroad if the acquirer resides or is seated in Poland and the civil law transaction took place in Poland.

Neither the Act on civil law transactions tax nor other tax laws define the place of exercise of property rights. In practice it is assumed that in the case of cash receivables one should rely on the civil law notion of the place of performance, referred to in Art. 454 k.c. Pursuant to the above regulation, the place of performance should be specified in the content of a legal relationship creating the obligation of a given performance or it should arise from the nature of the obligation. If the place of performance was not specified or it does not arise from the nature of an obligation, the cash obligation should be performed at the place of residence or seat of the creditor at the time of performance.

In the said judgment the court rightly pointed out that the receivables acquired by a Polish taxpayer should be originally repaid to the assignor (the company seated abroad). In light of Art. 454 k.c. the place of performance (place of exercise of the property right for PCC purposes) as of the date of acquisition on the receivables was situated abroad. Additionally, the sale agreement was concluded abroad. Therefore, the abovementioned prerequisites of PCC taxation of the sale of receivables (the sale of property rights) were not fulfilled and the transaction should not be taxed with PCC in Poland.

The said judgment should contribute to the change and unification of tax rulings issued by tax authorities in this respect. In practice, the tax authorities often take a stance that the assessment of the place of performance of property rights should take into consideration whether the receivables, when acquired, will be repaid to the bank account of the acquirer of the receivables in Poland or abroad. A proper structure of the acquisition of receivables from a foreign entity allows to avoid PCC on this transaction even in light of such interpretation.

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VAT tax point for construction and construction-assembling services

Ruling description

In its ruling of 30 July 2015 (case no. III SA/Wa 393/15), the Province Administrative Court in Warsaw (WSA) pronounced that, for the purposes of VAT, construction and construction-assembling services should be deemed to be performed at the moment of their physical completion and not at the moment of drawing up the acceptance protocol for the works.

Pursuant to the provisions of Art. 19a (5) point 3 letter a of the Act of 11 March 2004 on the tax on goods and services (hereinafter "VAT Law"), the VAT tax point for the provision of construction and construction-assembling services arises at the moment of issuing an invoice. Pursuant to Art. 106i of the VAT Law, an invoice for construction and construction-assembling services is issued no later than on the 30th day following the day of performing such services. Hence, the interpretation of the notion of the "provision of construction and construction-assembling services" is of key significance when determining the moment of issuing the invoice and, consequently, the occurrence of the tax point.

In the case analyzed by the WSA, a company was performing construction and construction-assembling services under contracts executed on the basis of FIDIC Terms and Conditions. The taxpayer asserted that the moment of completing the service takes place only when the services are accepted by the contracting authority. The acceptance of a service by the contracting authority takes place when the interim payment certificate is accepted or the final payment certificate is accepted, as the case may be. The tax authority that was addressed by the taxpayer with a request for a tax ruling pronounced the taxpayer's position to be incorrect. The tax authority stated that the actual completion of works will be the pivotal factor used to determine the completion of construction and construction-assembling services instead of the acceptance of such services by the contracting authority on the basis of release and acceptance protocols or other documents (such as a take-over certificate, completion certificate, or interim or final payment certificate). The WSA shared the tax authority's position

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Comment

The WSA ruling should be evaluated negatively. In the construction sector, the cooperation of the contractor and the contracting authority is needed to determine whether the works have actually been completed. The completion of construction work is not an objective event since the contracting authority must confirm that the contractor actually performed the commissioned work. Making the occurrence of the tax point and the moment of issuing the invoice contingent on the physical completion of works may lead to the situation where the contractor will be forced to issue an invoice and pay VAT despite the fact that the contracting authority does not accept the works and the invoice so issued. Hence, the contractor will be exposed to the risk of losing its liquidity due to the need to pay VAT to a revenue office at the time when no monies are remitted by the contracting authority. We recommend our clients from the construction sector to observe tax practice and act with prudence when drafting contractual provisions that determine the moment of completing construction works.

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Remuneration in consideration of loans extended and calculated as a percentage of profits achieved is not classifiable as tax deductible cost for the remuneration paying company

Ruling description

In June 2015 the Supreme Administrative Court (NSA) handed down a judgment (case no. II FSK 3272/14) concerning the classification for tax purposes of the part of the remuneration paid by the borrower to the lender calculated as a percentage of the profit achieved by the borrower.

The Company (the Borrower) entered into a loan agreement with a foreign entity (the Lender) for the sole purpose of financing a development project. Under the agreement, the Lender was to receive interest on the principal at an annual rate of 15% and on top of that the Borrower was to pay the Lender 20% of the profit it achieves, if any (a fee known as interest under profit participating loans).

The Borrower applied for a tax ruling to clarify the consequences its payments of interest under profit participating loans will have on the grounds of tax laws, arguing that these amounts shall be qualified as its tax deductible cost.

The Borrower argued that this interest is payable under the loan agreement and is an expense that is reasonable and legitimate in its line of business. In particular, the Borrower explored other financing options, involving other lenders, and proposed that the manner of calculating these particular interest amounts does nothing to alter their status as tax expense given that parties to agreements are free to set interest rates in whatever way they see fit (as fixed or variable rates, or based on more complex instruments).

The Minister of Finance disagreed with the Borrower, finding that the agreement made by the Borrower cannot be deemed an agreement for a loan in the meaning of Article 720 of the Civil Code and that, therefore, the amounts payable thereunder, calculated as a percentage of the Borrower's profit, if any, cannot be classified as interest.

The competent Provincial Administrative Court (WSA) agreed with the argumentation of the Minister of Finance.

With its June judgement the NSA upheld the positions taken by the Minister of Finance and the WSA, denying the Borrower the option to classify the paid amounts of interest under profit participating loans as its tax deductible costs. These expenditures are directly linked to obtaining the loan and they were incurred in order to obtain this tax-neutral gain rather than to generate some specific revenue. The NSA also found that since the Lender's rights in this case greatly exceed those it would have under a loan agreement made

pursuant to Article 720 of the Civil Code, the agreement considered here is essentially an agreement for the joint implementation of a project serving to jointly benefit the Parties concerned which shoulder the risks that go with the project jointly and severally.

Comment

The position taken by the NSA in the judgment considered here is untenable. The business purpose of financing is to pay for business activities geared, by assumption, to generating tax revenue. One must also dispute the Court's finding that interest under profit participating loans is not classifiable as a tax deductible cost since the Lender incurs an additional business risk by making part of its profit from funding the Borrower's operations conditional on the business success of the given venture. There can be no doubt that the lender takes on a credit risk whenever it extends a loan, as the risk may materialize if the project financed with it fails. The projections of the severity of the risk involved may have a direct impact on the proposed amount and manner of calculation of the remuneration due to the lender – as was the case here when the higher risk taken on by the Lender (due to the likelihood of the Borrower failing to achieve profit) was compensated for by the Lender's entitlement to a specific percentage of the Borrower's profits.

Also, the fact that the interest rate that was calculated based on the Borrower's profit should not in itself prompt the conclusion that the loan is now no longer a debt instrument and that the interest now becomes a dividend – which is a direct consequence of the Court's verdict. The Lender's legal position will at all times definitely differ from that of a shareholder.

This is not the first judgment of this kind coming from the NSA, which suggests that caution must be exercised when entering into participating loan agreements. An important point to make here is that it is possible to come up with an interest formula that will make the interest classifiable as a tax deductible cost even if its amount is indirectly linked to the borrower's profits – as follows from some of the tax rulings issued by the Minister of Finance.

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No possibility to change the qualification of revenue upon discharge of an obligation

Ruling description

In an award of 29 July 2015, the Province Administrative Court in Warsaw ("WSA") held that the company does not have the possibility to make an adjustment of revenue that was previously ascertained as a result of an inspection. The lack of such possibility results from the fact that there is no possibility to qualify such revenue otherwise in the course of an interpretation proceeding.

A company carrying on business activities involving the construction of premises for rent ("Company") applied for a written tax ruling on the corporate income tax it paid. In 2008, the Company signed a preliminary lease agreement ("Agreement") with a future lessee ("Business Partner"). Pursuant to the Agreement, the Company issued a promissory note to the Business Partner in exchange for the monies to be used to finance the construction of the premises to let. The Company agreed with the Business Partner that the monies would be returned by it in the form of deductions from the lease rent to be paid in the future. The Agreement also stipulated that in the event that the promised agreement were not executed or the lessee were in default with the payment of the amounts due, then the amounts paid by the Business Partner to acquire the promissory note would become the compensation for the Company.

In the case at hand, the last of the clauses listed above was applied since, as a result of the economic slowdown, the promised agreement was never signed. Soon afterwards, the Tax Control Authority (UKS) made an inspection at the Company and, in the course of the inspection, the Authority qualified the monies paid by the Business Partner as a compensation paid out pursuant to the Agreement. As a consequence, the Company recognized revenue on that account.

A few years later, due to improved business prospects, the Company and the Business Partner expressed their intent to execute the promised lease agreement that

was originally abandoned. The Company addressed a question to the Head of the Tax Chamber in Warsaw as to the possibility to requalify the revenue that it obtained as the compensation in relation to the Agreement, and the potential revision of its tax return. According to the Company, execution of the promised agreement will result in an obligation to make an adjustment of revenue generated in 2008.

The interpreting authority did not share the Company's position, in response to which the Company made an appeal to the WSA.

The WSA dismissed the Company's appeal and expressed the view that the fact of the UKS making the inspection proceeding is crucial for resolution of the case. According to the Court, in its interpretation proceeding, the tax authority is bound by the findings made by the tax control authority. Otherwise, the individual tax ruling would be deprived of its guarantee function. Hence, it should be stated that the facts of the case established by the UKS are a definitive element that is not to be modified as a part of the application for an advance tax ruling or in the course of the interpretation proceeding. For that reason, the Company does not have the right to a potential adjustment since the interpreting authority was obligated by law to treat the revenue in question as compensation.

Comment

While the award of the WSA is correct as regards the merits of the case, it raises a number of doubts. The Company has no basis to revise the tax return. However, the source of its inability is totally different than the reason to which the Court pointed.

Under civil law, the renewal planned by the Company is not possible due to the performance of the obligation. The parties agreed that the compensation was paid, and for that reason the Company's position regarding the possibility to make the adjustment of revenue (in the form of compensation) was wrong. However, one cannot agree with the statement by the Court and the tax authority that the sole right to rectify a tax return is excluded as a consequence of issuing the results of a tax control.

Art. 81b par. 1 Clause 2 of the Tax Ordinance clearly reads that the taxpayer is entitled to rectify a tax return: a) "even after the completion of a tax inspection" and b) "even after the completion of a tax proceeding – to the extent not covered by the decision defining the amount of liability".

Additionally, the issuance of a tax inspection result does not preclude the possibility to apply for an individual tax ruling.

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