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Tax Review

Dentons Poland

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Introduction

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 November and December 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
Head of Tax Advisory Group

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Loan currency conversion does not generate any foreign exchange differences

Ruling description

In its ruling handed down on 9 December 2015, in combined cases (case file no. III SA/Wa 293/15 and case file no. III SA/Wa 294/15), the Regional Administrative Court in Warsaw ("WSA") held that loan currency conversion does not generate any foreign exchange differences and is tax neutral.

The Company requested a tax ruling concerning corporate income tax. In its request, the company stated that it was a special purpose vehicle incorporated to implement a specific real estate development project.

In connection with the project implementation, the company incurs various costs that are strictly related to the project. The investment is financed mainly with funds originating from external sources in the form of contracted loans. The said loans were contracted in foreign currency and were credited to the company's bank account denominated in foreign currency. Subsequently, the funds so received were sold to the bank in exchange for Polish currency which is utilized by the company to make payments related to the investment completion and, to a minor extent, to finance the company's liabilities incurred in the company's day-to-day operations.

In its request for a tax ruling, the company sought confirmation that at the time of selling the foreign currency to the bank certain foreign exchange tax differences were generated on the company's part.

In the tax ruling handed down by the Head of the Fiscal Chamber in Warsaw, the authority found the company's position to be incorrect. It argued that foreign exchange differences are not established in view of the circumstances of receiving or acquiring funds and cash, but they are established in view of the circumstances of the outflow of funds and cash in the sense of the disposal thereof. An exchange operation, such as, for example, a currency conversion, does not result in the generation of foreign exchange differences on the entity's own cash. Only the exchange of assets takes place in such an event, such assets being still held by one and the same taxpayer.

The company challenged the ruling handed down by the authority and filed an appeal against it to the WSA. The Court upheld the authority's considerations and assessed that the situation in which the loan was contracted, and then converted from the original foreign currency to the domestic currency, does not generate any foreign exchange differences. In doing that, the Court expressed the view that the operation of the loan currency conversion is tax neutral.

Comment

The ruling handed down by the Court should be accepted and the arguments raised by the Court recognized as they are founded by the case-law of administrative courts and the clear-cut position taken by the tax authorities.

The key premise for the possible creation of foreign exchange tax differences is the satisfaction of the taxpayer's liability (by means of the repayment or set-off). As a matter of fact, the completion of a loan currency conversion does not result in the liability being satisfied. It only brings the exchange of currency in which the liability is denominated.

Since the loan currency conversion is to be deemed as tax neutral, then, as a consequence, when classifying foreign currency operations in tax terms, one should bear in mind the distinction made by the Court. Namely, foreign currency tax differences are to be distinguished from differences in foreign exchange rates that result from currency conversions, which do not have any impact on the amount of the taxpayer's revenues or costs. A failure to make such a distinction may result in negative tax consequences.

Maciej Sopel
Consultant
maciej.sopel@dentons.com

PIT taxation of bitcoin sales

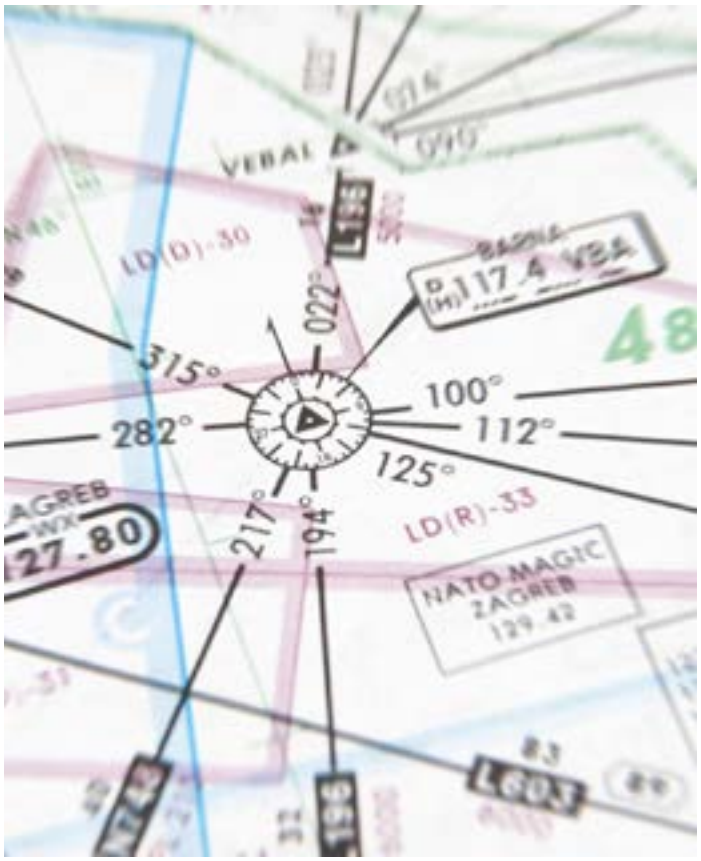
Ruling discription

In its judgment of December 16, 2015 (case file no. I SA/Gd 1551/15) the Provincial Administrative Court in Gdańsk found that virtual currencies (bitcoins) are classifiable as property rights for the purpose of identifying sources of revenue subject to personal income tax (PIT) because they are transferable (tradeable) and have a determinable pecuniary value. The revenue from transfers of bitcoins against consideration must therefore be classified as revenue earned from property rights (Article 10(1)(7) in conjunction with Article 18 of the PIT Act), regardless of whether the bitcoins were "mined" or acquired from a third party. The Court concluded that in accordance with Article 22(1) of the PIT Act, the costs of earning revenue from bitcoin transfers against consideration must include all the actually incurred and properly documented costs of acquiring the bitcoins, such as the price paid to purchase them. The costs of earning revenue from property rights may not include the cost of purchasing computers or other equipment as expenditures of this kind are outside the scope of purposes referred to in Article 22(1) of the PIT Act. In the statement of grounds for its judgment, the Court noted that the issue of legal classification of revenue from bitcoin sales had already been considered by the Provincial Administrative Court in Warsaw in its judgment of September 11, 2015 (case file no. III SA/Wa 3374/14) and that it fully agrees with the views expressed by this latter court.

Comment

Bitcoin transactions are increasing in number and it is to be expected that their significance in business dealings will grow as IT technology develops. No separate legislation was promulgated in Poland to regulate the tax consequences of these transactions and the rulings of administrative courts must thus be seen as key in taxation practice. The judgment considered here provides important clues for natural persons concerning the PIT due in connection with bitcoin sale transactions. It is very likely that future judgments issued by administrative courts will reiterate the conclusions arrived at in the judgment of the Provincial Administrative Court in Gdańsk referred to, and the earlier judgment of the Provincial Administrative Court in Warsaw. Entities involved in bitcoin transactions are thus advised to carefully monitor the taxation practice and the relevant court rulings concerning not just income taxes but also VAT and tax on civil law transactions.

Tomasz Prokurat
Legal Advisor, Tax Advisor
tomasz.prokurat@dentons.com



Taxation of remuneration from incentive scheme certificates received by supervisory board members

Ruling description

The Provincial Administrative Court in Gliwice found in its judgment of November 3, 2015 (case no. I SA/Gl 352/15) that when members of a supervisory board receive additional remuneration from transfers of certificates against consideration, this remuneration must be classified as revenue from activity carried on personally rather than as revenue from money capitals.

The taxpayer concerned sat on the supervisory board of a company which, in a bid to motivate members of both its management and supervisory board members to work better to improve the company's financial performance, invited them to participate in an incentive scheme. Agreements were concluded under which each participant in the scheme received a certain number of certificates at the beginning of an agreed settlement period. The certificates, distributed free of charge, were in book-entry (dematerialized) form and intended for eventual transfer to the company. The amount received in consideration of the certificates depended on the net profit achieved by the company in the given settlement period. The taxpayer held that the certificates were in fact derivative financial instruments in the meaning of the Act on Trade in Financial Instruments, emphasizing also that all the amounts received by the incentive program participants will have been an element of the remuneration paid to them as holders of their respective positions in the company. This interpretation was to follow from the applicable by-laws and the provisions of the documents appointing the board members to their positions.

The taxpayer applied to the Minister of Finance for confirmation that the revenue from the transferred certificates is to be classified as revenue from money capitals referred to in Articles 10(1)(7) and 17(1)(10) of the Act on Personal Income Tax. These Articles list revenue from the transfer against consideration of derivative financial instruments among other forms of revenue from money capitals. Revenue of this category is subject to PIT at the rate 19 percent.

The tax authority and later the Provincial Administrative Court (WSA) in Gliwice disagreed with the taxpayer. According to the WSA, the source of the certificates is the appointment relationship between the company and the taxpayer. In other words, had the taxpayer not been a member of the supervisory board, he would not have received the certificates. The court was in no doubt that the incentive program cannot be seen as involving any kind of hypothetical trade in certificates and that there can be no talk of any revenue earned in this kind of trade. As a result, the revenue from the transfer of the certificates must be deemed revenue from activity carried on personally (like the rest of the remuneration

paid to members of the supervisory board) subject to taxation with personal income tax at the progressive rate of 18 to 35 percent. The WSA in Gliwice pointed out that the taxpayer himself admitted that all the amounts paid to him under the incentive scheme will be an element of his remuneration received for sitting on the supervisory board.

Comment

The judgment issued by the WSA in Gliwice cannot be seen as sound. To begin with, it is inconsistent with the fundamental rule of PIT taxation whereby the various sources of revenue listed in statutory law must be seen as distinct. This judgment is also out of line with the prevailing trend in court rulings. To date, courts tended to hold that income from incentive schemes based on derivative instruments must be treated separately from employees' income or managerial personnel's income. The judgment of the WSA in Gliwice may be the first of more judgments to come reversing the favorable approach taxpayers have been enjoying till now. On the other hand, it may also be that this judgment was prompted by the declaration made in the taxpayer's application for a tax ruling that all the amounts paid to him under the incentive scheme will be elements of his remuneration for sitting on the supervisory board. We recommend (as we have also done before) that our clients hedge the tax benefits under incentive schemes with tax rulings and continue monitoring developments in tax practice.

Sylwia Kulczycka
Tax Advisor
sylwia.kulczycka@dentons.com

CIT consequences of a transfer of assets of a liquidated limited liability company to its sole shareholder

Ruling description

The Provincial Administrative Court in Wrocław found in its judgment of November 16, 2015 (case file no. I SA/Wr 1563/15) that if a limited liability company undergoing liquidation (the "Company") transfers its assets in kind as liquidation proceeds to its sole shareholder, the Company will have earned revenue subject to CIT pursuant to Article 14a(1) of the CIT Act.

Comment

This ruling is worthy of notice as it is probably the first ruling to be handed down by an administrative court concerning the tax consequences faced by a company in liquidation making an in-kind transfer of assets to its sole shareholder following the addition of Article 14a to the CIT Act.

Before Article 14a of the CIT Act came into force, the administrative courts usually tended to rule that a handover of assets of a company in liquidation to its shareholder did not make the company liable to pay CIT since a transfer of this kind does not benefit the company in any way. Now, pursuant to Article 14a of the CIT Act (which applies, in principle, as of January 1. 2015), if a taxpayer renders a non-monetary performance and thereby settles its liabilities, whether in whole or in part —including its liability to repay a loan/credit facility, pay dividends, redeem shares or sell shares in order to redeem them the taxpayer is considered to have earned revenue in the amount of the liability settled as a result of the performance. The new regulation does not explicitly say that it applies also to transfers of assets as part of the company liquidation process.

In the case reviewed here the Company argued that the transfer of its assets to the shareholder is being made by operation of law and it therefore cannot be interpreted as a non-monetary performance intended to fulfill any obligation of the Company. The tax authority and then the court hearing the case both disagreed with this position, arguing that Article 14a of the CIT Act does not

contain an exhaustive list of events triggering taxable revenue and that the situations it does list are just some examples of what is being referred to. Therefore, when considering the provisions of the Commercial Company Code applicable to liquidations of companies, the court decided that in the case at hand the Company will in fact have fulfilled an obligation towards its shareholder, namely the obligation to hand over what is known as the liquidation amount, which in this particular instance will be in the non-monetary form of the Company's assets.

Article 14a of the CIT Act is a source of controversy and we will definitely be seeing more judgments elaborating on the rules of its interpretation. That said, the ruling reviewed here may signal an emerging trend that will prove unfavorable for taxpayers transferring assets as part of liquidations of companies.

Tomasz Krasowski
Tax Advisor
tomasz.krasowski@dentons.com

Rule of resolving doubts in favour of a taxpayer

Ruling description

The Minister of Finance in the General Tax Ruling of 29 December 2015 clarified the rules of application of Art. 2a of the Tax Ordinance which sets forth that any doubts as to the content of tax regulations must be resolved in favour of a taxpayer. The provision which came into force on 1 January 2016 raised doubts as to the scope of its application and powers of tax authorities stemming from it even before its adoption. Pursuant to Art. 2a of the Tax Ordinance any doubts as to the content of tax regulations that cannot be removed shall be resolved in favour of a taxpayer.

1. General

According to the Minister of Finance, the said rule shall only be applicable to doubts concerning the content of legal regulations. It does not however mean that an opposite rule shall be applicable to doubts as to the fact findings. Moreover, a direct addressee of a norm arising from the provisions of Art. 2a of the Tax Ordinance is a tax authority resolving a tax case. On the other hand, a taxpayer may draw a tax authority's attention to the necessity to apply the said regulation, and an unjustified refusal will serve as grounds for a procedural charge.

The rule of resolving in favour of a taxpayer shall also be applicable to cases concerning remitters, cashiers, legal successors of a taxpayer and third parties responsible for someone else's tax liabilities.

2. Fundamental rules of application of Art. 2a of the Tax Ordinance.

a. The said rule shall first of all be applicable in tax proceedings, but also in any cases in which the tax authorities apply legal regulations in an authoritative manner (e.g. the issuance of tax rulings). When interpreting legal regulations, a tax authority should take into consideration judicial decisions of the Court of Justice of the European Union.

b. To refuse to apply Art. 2a of the Tax Ordinance, a tax authority must prove that the content of a regulation does not raise any doubts in the case or – if a regulation actually raises doubts – it must prove that these doubts may be removed and the result of a correct interpretation of the regulation is different than specified by a taxpayer. Such a situation may occur as a result of reliance on regulations inadequate to the state of affairs, adoption of wrong interpretative assumptions, wrong reasoning, or if a taxpayer's argumentation is so weak compared to the opposite argumentation that it is hardly possible to assume that the doubts cannot be removed.

In such an event a statement of grounds for the refusal to apply Art. 2a of the Tax Ordinance will be a mandatory element of a decision or other resolution. When examining the legitimacy of the tax authorities' actions, an administrative court will be allowed to reverse a decision e.g. in a situation where a tax authority did not apply Art. 2a of the Tax Ordinance despite the existence of sufficient statutory prerequisites.

c. If a tax authority comes to the conclusion that there is more than one interpretation of a regulation that is equivalent and favourable for a taxpayer, it should choose the one which is more favourable for the taxpayer. An interpretation "favourable for a taxpayer" means a legal solution which is the best for the taxpayer from amongst all solutions considered when interpreting the regulation. Therefore, the application of Art. 2a of the Tax Ordinance will require determination of a "taxpayer's interest" in light of a given case.

A more "favourable" solution may also be indicated by a taxpayer in a calculation contained in a tax return or presented during tax proceedings. In such a case, if an authority cannot resolve which interpretation is more favourable for a taxpayer (e.g. both interpretations are favourable for a taxpayer, but - in other fields of operation of tax law – choosing one of them will lead to the loss of benefits arising from the other), it should establish the taxpayer's position as to the selection of the most favourable interpretation.

Comment

The issuance of a general tax ruling of the Minister of Finance deserves a warm welcome, even before its entry into force. It extensively clarifies the correct understanding and rules of application of the said rule by tax authorities. However, the issuance of the tax ruling does not resolve doubts as to whether the rule will be properly applied in practice, as the application of an interpretation favourable to a taxpayer will lead to measurable tax benefits. Therefore, when applying this rule ex officio, the tax authorities will have to refrain from a pro-fiscal adjudication and assuming that a possible dispute will be settled by a court. Therefore, we shall attentively watch the direction the adjudication practice of tax authorities' takes when the regulation comes into force.

Rafał Mikulski
Advocate
rafal.mikulski@dentons.com

Contact

Karina Furga-Dąbrowska
Partner
Head of Tax Advisory Group
D +48 22 242 57 63
karina.furga-dabrowska@dentons.com

Cezary Przygodzki
Partner
D +48 22 242 57 78
cezary.przygodzki@dentons.com

Dentons
Rondo ONZ 1
00-124 Warsaw

T +48 22 242 52 52
F +48 22 242 52 42
dentonstaxadvisory@dentons.com

dentons.com

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