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Tax Review

Dentons Poland

APRIL 2016

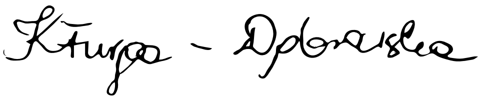
Introduction

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 March 2016. 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
Dentons

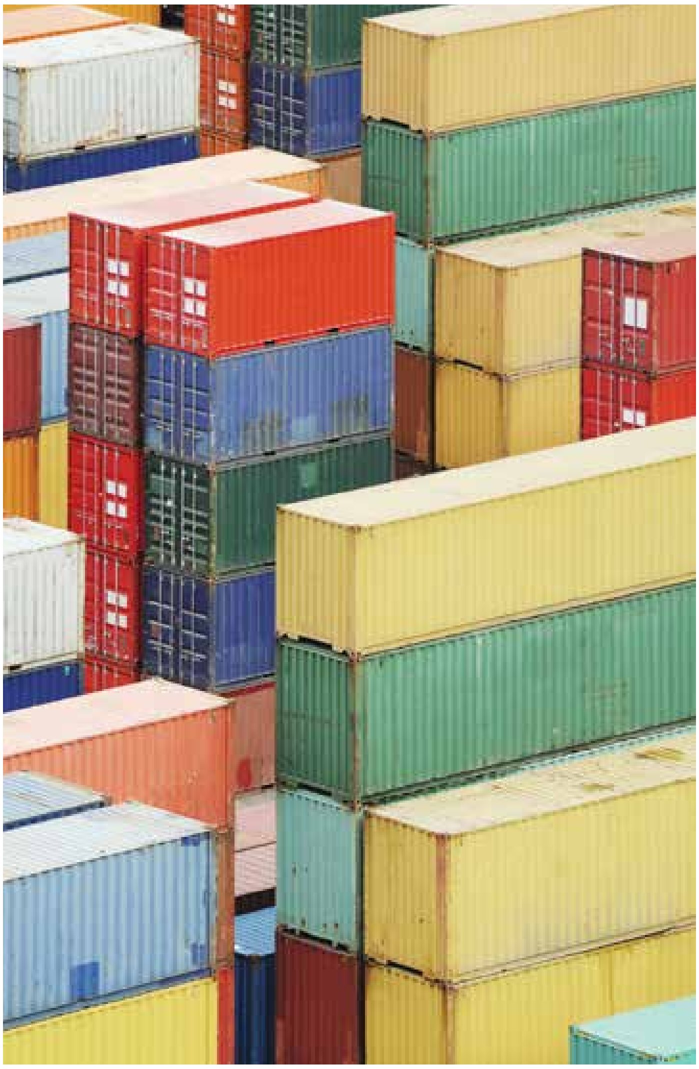
Contents

CIT consequences of a merger without economic justification

Description

The Provincial Administrative Court in Gdańsk, ruled on March 16, 2015 (I SA/Po 1630/15) that the revenue generated by the merger of companies when the merger lacks economic justification as referred to in Article 10 Section 4 of the CIT Act, is subject to taxation, on the level of the surviving company, pursuant to general tax principles.

A limited liability company ("Company") applied for an individual tax ruling concerning its corporate income tax (CIT) liabilities. The Company stated that it would become a partner in a joint-stock limited partnership that will be merged into the Company. Before the merger the joint-stock limited partnership would be transformed into a limited liability company. In view of the fact that on the date of the merger the Company would hold 100% of shares in a share capital of the limited liability company, the merger would be conducted without increasing the share capital of the Company. Further to the planned restructuring, the Company inquired whether, in a situation in which the said restructuring is not conducted for economic reasons, the Company would generate income from participation in the profits of legal persons. The Company expected confirmation that if it was found that the merger was not conducted for justified economic reasons, the Company would generate income from participation in the profits of legal persons as referred to in Article 10 Section 1 of the CIT Act and, in consequence, the said income could be subject to



the income tax exemption based on the principles as provided for Article 22 Sections 4-4b of the CIT Act.

Both the Head of the Tax Chamber and the Provincial Administrative Court ruled that the generated income upon merger should not be deemed to be income under Article 10 Section 1 of the CIT Act, but the income should be subject to taxation pursuant to general tax principles. Due to the fact that the income would be related to the acquisition of a company, it cannot be treated as payment referred under Article 22 Section 1 of the CIT Act. By the same token, the exemption under Article 22 Section 4 of the CIT Act would not apply. Consequently, the income of a parent company in relation to the takeover of the assets of a limited liability company would not be subject to a CIT exemption on the principles specified in Article 22 Sections 4-4b of the CIT Act.

Comment

Thus far, the problem of economic justifiability of a merger has not been the object of too many court rulings. In practice, the stance favoured to date in respect of upstream mergers was that, if a surviving company being a shareholder in a target company for a minimum period of 2 years, the possible income which could be generated in connection with the merger should be subject to tax exemption as provided for in Article 22 Sections 4-4b of the CIT Act. The stance confirmed by the commented court ruling indicates that there is a risk that the tax authorities may in future question the above approach. If a merger is considered, it is highly advisable to carry out a detailed analysis, including its evidenced economic justification, in order to eliminate this negative interpretation.

Tomasz Krasowski
Tax Advisor
tomasz.krasowski@dentons.com

General ruling on completion of construction work as a VAT chargeable event

Description

The Minister of Finance issued a general ruling on April 1, 2016 (file ref. no. PT3.8101.41.2015.AEW.2016.AMT.141), defining the moment when VAT becomes chargeable on construction work.

Article 19a(5)(3)(a) of the VAT Act of 11 March 2004 provides that VAT in the case of construction or construction and assembly work becomes chargeable upon the issuance of the invoice for the work at issue, while Article 106i of the VAT Act requires invoices for this kind of work to be issued no more than 30 days after their completion. The interpretation of what is meant by "completion of construction or construction and assembly work" is thus key in determining the time of invoicing and the moment when tax becomes chargeable on the work done.

The view currently embraced by tax authorities and courts is that construction or construction and assembly work is completed when it is finished "in actual fact". This gives rise to a host of practical problems as it is both the building contractor and the contracting entity that must agree when the works have actually been finished.

The Minister of Finance now ruled that

1. by date of completion of a construction or construction and assembly service is to be meant the date when the service is actually completed, that is to say the date when the contractor has finished a contractual service or a portion thereof (if the service was to be rendered in parts) and has announced the work to be ready for inspection and acceptance (when the contractor decides that the service or its part is ready for inspection and acceptance by the party purchasing the service);

2. if the service is to be accepted in parts, which is when the contract requires regular payments to be made following the completion of parts of the ordered construction or construction and assembly service, a given part of the service is deemed completed when the contractor actually finishes performing the given part of the service (the given part of the service has been actually rendered) and invites the party purchasing the service to inspect and accept the works (Article 19a(2) of the VAT Law);

3. if a service is provided on an ongoing basis (with successive dates of payments and settlements defined), the service is deemed completed upon the lapse of every period to be paid for and settled. If a service is provided on an ongoing basis for more than a year at a stretch and the said applicable dates of payments and settlements fall beyond a year's end, the service is deemed completed at the end of each tax year, until the end of service provision (Article 19a(3) of the VAT Law). The Minister of Finance also clarified that if it is possible to identify distinct activities comprising the construction service provided in any given settlement period, this service may not be deemed as one provided on an ongoing basis.

Comment

The general ruling is not advantageous to taxpayers. The process of works acceptance under construction contracts is lengthy, consisting of multiple stages, and is never guaranteed to end successfully. When tax chargeability and invoicing date is to be conditional on the works becoming declared ready for acceptance, the contractor may find itself forced to issue an invoice and pay VAT although the contracting entity refused to accept the works and the invoice it received. If this happens, the contractor may find itself facing loss of financial liquidity as it will have to pay the VAT without being itself paid by the contracting entity for the work it performed.

It is to be expected that the general ruling discussed here will have significant bearing on decisions taken by tax authorities in practice. We recommend that our clients explore adequate contractual remedies, such as making the contracting entity liable for interest accrued on tax arrears when the acceptance of the works is wrongfully delayed.

Sylwia Kulczycka
Tax Advisor
sylwia.kulczycka@dentons.com

Positive goodwill is a type of property right subject to PCC taxation

Description

In a judgment handed down on March 16, 2016 (case file no. I SA/Gl 1220/15), the Provincial Administrative Court in Gliwice held that a positive value of goodwill earned as a result of the sale of an enterprise [Polish: przedsiębiorstwo] is a property right and, for this reason, just like any other assets, it is subject to the tax on civil law transactions (PCC) levied on the purchase agreement.

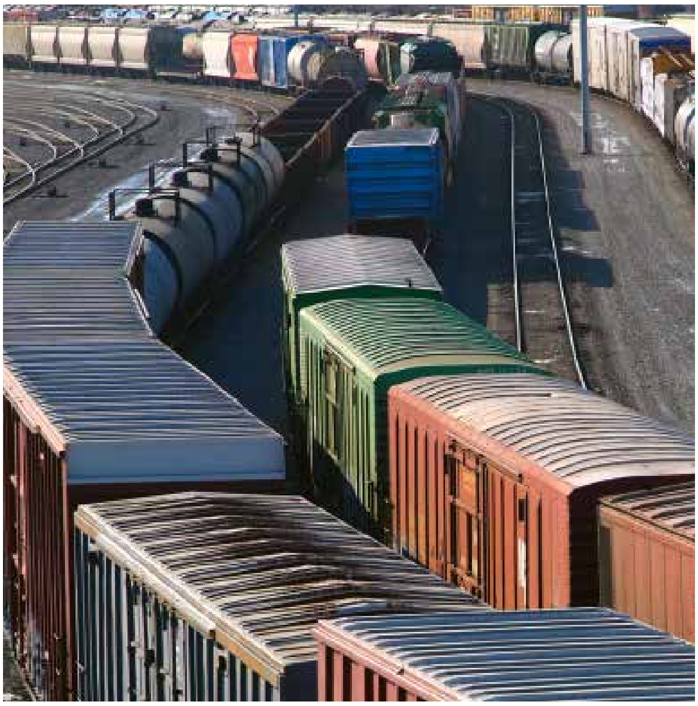
The taxpayer involved in the case argued that goodwill was merely a specialist term (used in balance sheets and tax parlance) and did not amount per se to a property right, because it apparently did not have features characteristic of property rights, in that it could not independently constitute a subject matter of a legal transaction or a civil law dispute between parties to the legal transaction. Consequently, the goodwill assessed for accounting and/or CIT purposes should not be subject to PCC, as it does not constitute a property right expressly listed in the applicable statutory regulations as one subject to PCC. The court did not agree with the taxpayer's argumentation and dismissed his appeal. When orally providing the statement of grounds for the judgment, the court stressed that positive goodwill has the nature of a property right, because it constitutes a quantifiable value, is inextricably attached to the enterprise and can be disposed of as a constituent part of the enterprise. Moreover, goodwill becomes quantifiable only if and when a prospective purchaser is able to assess its value. According to the court, positive goodwill is an asset value on intangible rights. By the same token, in the court's estimation, assessment of the tax base should not be a problem and the difference between the value of individual assets of the enterprise listed in the purchase agreement and the price charged by the seller will become the tax base for PCC taxation.

Comment

The tax base for PCC purposes in the case of sale of an enterprise has been a notoriously controversial problem. One of the most essential issues is whether or not to include goodwill in the tax base, considering that goodwill is neither a thing nor a property right (in terms of civil law) but an accounting and tax term denoting the difference between the purchase price of the enterprise and the net fair value of all assets purchased, where the latter is lower than the former. Despite worthy arguments cited to support the thesis that no PCC will apply to positive goodwill, in the present case the court chose a

pro-fiscal interpretation of the PCC Act, thereby following in the footsteps of other administrative courts in similar cases. Hopefully, in the written statement of grounds the court will provide exhaustive argumentation on why it decided to treat goodwill as a property right, unlike previous judgments in similar cases. Notwithstanding the foregoing, a taxpayer intending to purchase an enterprise or an organized part of an enterprise must factor in the risk of having to pay PCC on goodwill or carefully structure the transaction so as to minimize its tax exposure.

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



A PICIS fund co-managed by a board consisting of private individuals and an investment firm is not eligible for CIT exemption

Description

By a judgment of March 11, 2016 (case file no. III SA/Wa 2732/15), the Provincial Administrative Court ("WSA") confirmed that earnings of a foreign fund are not eligible for a CIT exemption if the fund is co-managed by a managing company and a board consisting of natural persons.

In its application for a tax ruling, the Company explained that a Cypriot special vehicle managed by a board consisting of natural persons (and eligible for private investment fund status ("PICIS")) was going to become its majority shareholder in the future. PISIC was also going to appoint an independent investment manager in the form of a Cypriot investment firm having its registered office in and duly licensed in Cyprus to manage PICIS assets and business, such manager to approve certain material decisions regarding the PICIS before they are implemented. The Company also explained that to have PICIS status and the status of an investment firm, relevant permits must be procured from the Cypriot Securities Commission.

In connection with the foregoing, the Company enquired whether a Cypriot investment fund with PICIS status was exempt from CIT under Art. 6(1)(10a) of the Polish CIT Act, i.e. exemption for 'co-financing entities'. The Tax Office Director's reply to the enquiry was negative and he stated that a PICIS cannot avail itself of the exemption because it does not fulfil one of the premises in that the proposed management system does not allow the assumption that the PICIS will be managed by an entity duly licensed by the relevant financial regulator of the country of its registered office.

As a result of an appeal filed by the Company, WSA ruled that considering that in the description of a future event the Company stated that the PICIS would be in practice effectively managed by a licensed manager, the aforesaid premise must be assumed to be fulfilled.

The Tax Office Director appealed against the WSA judgment to the Supreme Administrative Court ("NSA") which granted the last resort appeal. In consequence, the case was remanded to WSA, which ultimately ruled that considering that in the case at issue the PICIS was co-managed by an investment firm and by private individuals sitting on its board, all of these entities must fulfil the aforesaid premise as they co-manage the PICIS. Consequently, it cannot be assumed that a PICIS managed in this manner is eligible for the tax exemption

because natural persons cannot have a "registered office" (as they only can have "a residential address or a business address") in the country whose relevant financial regulator licensed it to manage funds.

Comment

At the outset, we need to note that the problem at issue concerns the method of managing foreign co-financing institutions and has already been resolved at the NSA level. Unlike in the case of the other judgment, NSA, in its judgment of July 24, 2015 (case file no. II FSK 1455/13), ruled that a fund (including those with PICIS status) is eligible for CIT exemption even if the management is delegated to a managing firm.

For this reason we cannot agree with WSA's conclusions, as the provincial court ignored the fact that the management board of the PICIS delegated its right to manage the fund to an investment firm. As a result, the investment firm is the managing company of PICIS, not the private individuals, and consequently only the status of the investment firm ought to be taken into account to assess whether the PICIS is eligible to the CIT exemption. The WSA judgment consequently unlawfully restricts the fund's right to the exemption under Art. 6(1)(10a) of the CIT Act.

The judgment at issue is also testament to the fact that although this exemption has been in effect for over four years, the courts seem to have an inconsistent stance on this matter. For this reason we recommend that each fund structure be analyzed in detail, especially as the exemption may depend on compliance with foreign regulations.

Maciej Sopel
Consultant
maciej.sopel@dentons.com

Failure to recover a tax overpayment within a set time limit extinguishes the compensatory liability of an authority

Description

The Supreme Court, in its ruling dated March 17, 2016 (case file no. V CSK 413/15), precluded the taxpayer from seeking compensation in a situation in which the taxpayer failed to apply for a tax overpayment before the lapse of the statute of limitation.

The taxpayer, in order to confirm that specific expenses may be treated as costs of earnings, applied for an individual tax ruling concerning PIT. In response, the head of the tax chamber supported the stance adopted by the taxpayer. In order to comply with the tax ruling, it was necessary to submit the corrected tax returns for the years 2006-2007 and apply for the tax overpayment. Earlier, i.e. in March 2008, the Tax Inspection Office (Polish acronym: "UKS") initiated the tax audit with respect to PIT for the years 2006-2007 and the option to correct the tax returns was temporarily suspended. The UKS supported the stance upheld in the individual tax ruling and in April 2009 presented the results of the audit. The final correction and the motion for the PIT overpayment for the year 2006 was submitted in April 2013. The head of the tax office, however, refused to initiate proceedings concerning the tax overpayment and indicated that the statute of limitations of the tax liability lapsed on December 31, 2012.The taxpayer brought action against the UKS and requested compensation. The taxpayer claimed that the tardiness of UKS and excessively long audit procedure made it impossible for the taxpayer to seek a refund of the tax overpayment.

The courts of the first and the second instance, however, did not support the stance taken by the taxpayer and the case was brought before the Supreme Court which dismissed the final appeal. The Supreme Court found that the taxpayer did not prove any loss in assets (damage) which would justify the compensatory claim. In addition, it was not proven that the authority acted in a dilatory manner.

Comment

The stance adopted by the courts is by no means surprising. The taxpayer was able to file for the overpaid tax, however, did do so too late. Furthermore, the tax ruling does not constitute grounds to determine and refund the tax overpayment. There was also no decision handed down in the discussed case with respect to the tax assessment.

The compensatory procedure aims at compensation for damage incurred by the unlawful actions of the administrative authorities. That aim, however, does not extend to the simple continuation of a tax dispute. It is necessary to prove that unlawful actions had been taken by the tax authority, the occurrence of damage and the causal link between the event causing damage and the damage itself. The case in question lacks these preconditions.

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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