KSP TAX NEWS 07/2013

We are pleased to present you KSP Tax News, in which we describe selected rulings passed in June 2013. We hope this publication proves useful in your everyday operation.

Expenditures on meetings with contractors and tax deductible costs – the judgment of seven judges of the Supreme Administrative Court

The Supreme Administrative Court in its judgment issued by seven judges on 17 June 2013 (files no. II FSK 702/11) decided that the lack of the statutory definition of representation does not justify the possibility of creation, by means of the SAC resolution, of such a definition which would actually be of normative nature. As a consequence, in each case it should be determined whether a particular expenditure may generally be considered as tax deductible cost and afterward, whether it can be additionally qualified as cost of representation.

Expert comment

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"SAC had to settle the issue, whether the expenditures on the purchase of catering services provided during meetings with clients held at the premises of the taxpayer's seat as well outside of this seat and included to the category of expenditures specified in Article 15 sec. 1 of the CIT Act, should in any event be considered as costs of representation which do not constitute tax deductible costs. Referring to the lack of the definition of 'representation' in the CIT Act, the court pointed to the necessity of an individual approach to each case. The court was critical with regard to the standpoint, according to which, each expenditure on catering should be excluded from tax deductible costs in advance. What is more, the court underlined that the basic assessment criterion is, whether the aim of the expenditures is simply to improve the company's image or to obtain income.

With this ruling, SAC will not make the entrepreneurs' lives easier. Although, the finding that not every catering expenditure means representation because it should be firstly analyzed whether it is related to income, e.g. contributes to the conclusion of a contract, should be considered as positive. Nevertheless, the taxpayers will still have a lot of doubts as to the effects resulting from the incurring such expenditures in particular situations. The administrative courts, as it is now, will have to assess the circumstances individually in relation to the expenditures incurred by taxpayers within this area of activity. Due to the unclear boundaries of the concept of representation, the settlements will be still divergent and similar factual states will be interpreted in different ways.

SAC noted that in this situation, a reaction of the legislator would be desirable in order to avoid further disputes between the taxpayers and tax authorities. The

court also pointed out that any exclusion from the costs, which is planned to be introduced by the legislator, should be precise – and in case of the costs of representation it is otherwise. We should only hope that we will see a clear definition of representation from the legislator, which will aim at least to dispel a part of doubts which arise in practice.

CIT

The Supreme Administrative ruled also with regard to tax deductible costs and costs of representation in its judgment of 12 June 2013 (files no. II FSK 2053/11) and dismissed the cassation appeal filed by the Director of the Tax Chamber in Katowice against the judgment of the Province Administrative Court in Cracow of 3 March 2011 (files no. I SA/Kr 2142/10).

The Company being a manufacturer and distributor of lightning equipment intends, within its business activity, to give the customers products and goods which are a part of the trade offer targeted to the contractors. The aim of the Company was to maintain good trade relations, to present its products and goods as well as increase in purchase and maintenance of knowledge concerning the products among the customers of the Company. The question addressed to the Director of the Tax Chamber related to the expenses incurred for the acquisition, production of products and goods, the designation of which was as specified above. According to the Company, such expenses meet the conditions specified in Article 15 sec. 1 of the CIT Act, therefore they should be considered as tax deductible costs and they are not subject to the elimination of tax costs as the representation expenses according to Article 16 sec. 1 point 28 of the CIT Act and it results from the purpose of incurred expenses. In this factual state, the activities of the Company do not serve as image building but only as a presentation of goods and products to the customers and what is more, the products of the Company will not be used by the customers for their own account. As a result, such expenditures should not be qualified as representation expenses. The Director of the Tax Chamber in Katowice did not agree with the Company's standpoint. The Province Administrative Court in Cracow repealed the contested interpretation. It stated that the fact that the actions were directed to a small number of recipients cannot constitute a circumstance which determines the concept of representation. Promotional activities may include indirectly elements related to the creation of the company's image which, however, do not prejudge their representative nature, if their purpose is to present the goods. The SAC shared the standpoint of the court of first instance and considered the Company's activities as an example of a typical advertisement and thus, the related expenditures cannot constitute representation costs.

VAT

The Supreme Administrative Court, in its judgment of 12 June 2013 (files no. I FSK 1128/12) dismissed the cassation appeal of the tax authority lodged against the decision of the Province Administrative Court in Poznań (files no. I SA/Po 880/11) and found that the internal settlements between the leader and the partners of the consortium do not constitute VAT taxable activities.

In the presented case, the Company concluded a preliminary consortium agreement, the aim of which was a joint participation in a tender concerning conclusion of an agreement on implementation of a public procurement involving

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the design and construction of a liquefied natural gas regasification terminal and putting it into service. In the subject case, the services are provided by the partners of the consortium for the leader and those services are invoiced in accordance with the provisions concerning the tax on goods and services, but there are also settlements which constitute only a system of internal settlements, transfers which previously were directed to the leader of the consortium. In the opinion of the court, with reference to the internal settlements between the leader and the partners of the consortium, there are no grounds to consider that in this case there are any reasons for VAT taxation of those settlements. The settlements of such type can be qualified neither as provision of services nor supply of goods. The court pointed out that not every transfer of funds has to be qualified as a supply of goods or provision of services.

The Supreme Administrative Court in its decision of 4 June 2013 (files no. I FSK 696/13), dismissed the cassation appeal lodged against the judgment of the Province Administrative Court (files no. I SA/Wr 1416/11) repealing the individual interpretation of the Director of the Tax Chamber in Poznań (files no. ILPP1/443-251/11-5/NS) and stated that granting loans by a holding to the subsidiaries from the assets derived from provision of services should be subject to VAT provisions.

In the presented case, a holding Company granted an interest-bearing loan to its subsidiary based in Poland. The Company also receives interest payments resulting from two loans granted to a subsidiary with its registered seat in the Czech Republic. The Company finances its operations from the issuance of shares and bonds, provision of the option scheme to the employees of subsidiaries. Those sources are not subject to VAT taxation and interest from granted loans exempted from VAT. The Company stated that it is not an entity providing financial intermediation services and it does not address its offer to third (external) parties. The Company does not exclude that in future it will grant further loans to subsidiaries. Nevertheless, granting loans will still be of intermittent nature. Therefore, a problem occurs with regard to VAT taxation of loans granted by a holding to subsidiaries. The SAC referred to the case law of ECJ issued in terms of loans granted by holding companies to subsidiaries. The SAC noted that it agrees to the full extent with the view presented by ECJ that the dividends from the owned shares or activities consisting of the sale of shares or securities are generally not considered in a particular case as an income from business activities, because they are outside the VAT system. Nonetheless, the SAC pointed out that according to the case law of ECJ, the interest received by a holding company as a remuneration for loans granted to the companies, in which this holding company holds shares, cannot be excluded from the scope of VAT, because those interest does not result simply from the ownership of the property but they constitute a remuneration for using the loan. As far as the analysed case is concerned, according to the SAC, it is essential whether the mere granting the loans resulted from using own property or it was a way to finance those funds for granting the loans. Pursuant to the SAC point of view, the funds from the issuance of shares or dividends constitute a way of financing and consequently the Company finances the funds which afterward will be used for granting the loans. According to the SAC, it results from the case law of ECJ that when a holding company uses funds being a part of the property from the provision of services which constitute the Company's business activity, the Company acts for business purposes, because those activities aims at maximizing the profits from the invested capital. Thus the

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loans granted to the subsidiaries will be subject to VAT taxation. Consequently, as far as the subject case is concerned, the loans granted to subsidiaries are subject to VAT taxation.

OTHER

The Supreme Administrative Court issued a resolution of seven judges (files no. I FPS 6/12) on 3 June 2013 concerning the influence of the notice on application of an enforcement measure with regard to the interruption of the running of the statute of limitations under Article 70 § 4 of the Tax Ordinance Act.

According to the resolution, application of an enforcement measure interrupts the running of the statute of limitations under Article 70 § 4 of the Tax Ordinance Act, in force since 1 September 2005, when the notification of a taxpayer on the application takes place before the expiry of the limitation period. The SAC points out that if we accept such a scheme that an enforcement measure can be applied without notification of the taxpayer within a specified period of time, there would be a state of uncertainty as to the law. In such a situation, there would be an interruption of the limitation period, a fact which the taxpayer is not aware of. According to the SAC, an uncertainty as to the law is undesirable, in particular when it concerns an important issue related to the statute of limitation period. Therefore, it is not sufficient to apply an enforcement measure before the limitation period and notify the taxpayer about this fact after this period. In such a case, the running of the statute of limitations is not interrupted.

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If you wish to be provided with additional information in this respect, please contact us.

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