KSP TAX NEWS 08/2013

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

Premises for recognizing a transaction as an abuse of VAT-related laws - a verdict by the Province Administrative Court *[WSA]* of Bydgoszcz

The Province Administrative Court of Bydgoszcz, in the judgment of 23 July 2013 (file I SA/Bd 378/13), held that the VAT-related law is abused if the main purpose of transactions is to derive a significant tax benefit which is non-compliant with the objectives of the regulations. In this situation it is reasonable to apply the so-called tax evasion clause stipulated in Article 88 par. 3a (4) of the VAT Act, and deprive the taxpayer of the right to deduct input VAT.

In the situation considered by the Court, associated enterprises have entered into a series of mutual (lawful) transactions which resulted in generating a substantial amount of input VAT for one of them. Correspondingly, on the side of two other companies, an output VAT of significant amount occurred. However, soon after the transactions were made, the companies declared bankruptcy, and the VAT had not been paid. The transactions made by the parties involved, *inter alia,* an amendment to a service contract consisting in an increase of contractual penalties, and subsequent termination of the contract, which led to the obligation of contractual penalty payment by the companies that subsequently went bankrupt, as well as disposal of fixed assets by the companies, the payment for which was effected by deduction with the contractual penalty owed. Additionally, the parties voluntarily chose a VAT-able transaction of real property sale, although they were entitled to choose tax exemption. Having considered the facts, the tax authority issued a decision assessing the amount of tax pursuant to Article 88 par. 3a (4) of the VAT Act, which provides that invoices and customs documents shall not be treated as a basis for reduction of output tax and refund of the difference or refund of input tax when the the documents confirm transactions to which the provisions of Article 58 and 83 of the Civil Code apply. The WSA of Bydgoszcz dismissed the complaint against the decision of the authority and considered the same justified.

Expert Comment

"In the case at hand, the tax authorities deprived the taxpayer of the right to deduct the input VAT justifying the same with the tax evasion clause under Article 88 par. 3a (4) of the VAT Act. The WSA of Bydgoszcz considered the decision justified by reference to the law abuse premises contained in the verdicts issued by the Court of Justice of the European Union, being the basis for implementing the tax evasion clause in the Polish VAT Act. The WSA judgment is significant insofar as it provides for detailed premises to be used to recognize that VAT-related regulations have been abused. The Court

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resolved that this type of abuse occurs when a transaction conforms to the formal requirements of the VAT regulations, but the only objective reason for making the transaction is to derive a tax benefit which is non-compliant with the objectives of the regulations. Additionally, the Court emphasized that no legal regulation existed that imposed upon a taxpayer the obligation to act so as to generate the highest possible tax liability, and the Polish law provided for the possibility of tax optimization. The judgment indicated that to apply the clause, it was necessary for the tax benefit derived to be non-compliant with the objectives of the statutory regulations. This was the case in the factual situation considered by WSA of Bydgoszcz. As one of the parties deducted the tax which was not paid by the other party due to its bankruptcy, the principle of VAT neutrality was upset. Deriving a tax benefit in the form of VAT deduction was non-compliant with the objectives of the Act, as the parties were aware that the output VAT would eventually not be paid. The above indicates that the reasonableness of applying the tax evasion clause should be evaluated in line with two key criteria. The first one is the existence of an objective reason for making a transaction. If tax optimization is just one of a number of economic objectives for a transaction, the tax evasion clause should not be applied. Evaluation should also be made of the way in which the parties act, their awareness and the purpose of the actions they undertake in the context of their conformity with the principal rules underlying the tax structure. The tax evasion clause is reasonably applied when the parties perform a transaction solely for the purpose of deriving a tax benefit in a manner non-compliant with the objectives of the legal regulations".

CIT

Head of the Fiscal Chamber of Katowice, in the individual interpretation of 2 July 2013 (file IBPBI/1/423-423/13/AK), confirmed that with respect to a comprehensive cash pooling service provided by a bank, which encompasses calculation and allocation of interest among participants, provisions on transfer pricing are not applicable to the interest.

The interpretation applies to zero balance domestic cash pooling. According to a cash pooling agreement, the bank transfers funds between the account of the agent and the accounts of participants. The Bank also calculates the interest due to the participant on credit balance or payable by the participant on debit balance and allocates the same to accounts on a monthly basis, deducting or adding its markup. The applicant was of the opinion that the fact of the amount of interest due being determined by the bank, i.e. a non-associated enterprise, meant that it was determined at market level, and hence no transfer-pricing regulations needed to by applied. In its interpretation, the authority considered the standpoint correct. The interpretation acknowledges the current trends in decisions and verdicts issued by the tax authorities, whereby provisions on transfer prices or thin capitalization are not applicable to interest accrued and allocated by the bank under cash-pooling. Considering this standpoint of the tax authorities, if the role of the cash-pooler is performed by a bank rather than by an entity of the capital group (an agent), the tax risk related to the restrictions imposed on transactions between associated enterprises can be avoided.

VAT

The Minister of Finance, in the general interpretation of 26 June 2013 (file PT3/033/1/101/AEW/13/63224), specified the manner of VAT adjustments in connection with the judgment of the Court of Justice of the European Union in

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the case C-224/11 (BGŻ Leasing Sp. z o.o.), in which the standpoint presented so far by administrative courts (such as the resolution by the 7 judges of the Supreme Administrative Court [NSA], file I FPS 3/10) whereby insurance for the leased item should be included in the taxable base for the leasing services, was considered as non-*compliant with the Community laws.*

The general interpretation applies to situations of taxpayers adhering to the NSA resolution, i.e. situations in which the insurance of a leased item was taxed in the same way as the leasing service, while it did not meet the requirement to be considered an ancillary service and, according to the CJEU judgment, it should be VAT-exempt as an insurance service.

1. **The Lessor - output tax.** If the lessor assumed the tax burden, paid the VAT on the insurance service, but did not document the same with an adjusted invoice, it may make the relevant adjustments either in the current tax return, or by adjusting the return in which the original settlement was made. Where the lessor, adhering to the NSA resolution, issued the adjusted invoice and assumed the tax burden (applied the gross value method), it may issue the adjusted invoice again and settle it in the current return. Where the lessor, adhering to the NSA resolution, issued the adjusted invoice and transferred the tax burden to the lessee (applied the net value method), it may issue the adjusted invoice again and settle the adjustment in the current return provided that it refunded to the lessee the amount corresponding to the VAT previously added.
2. **The Lessee - input tax.** The steps to be taken by the lessee depend on whether it received an adjusted invoice from the lessor or not. If the adjusted invoice was provided, the lessee shall adjust the deducted input VAT in the current tax return. If the lessor did not issue the applicable adjusted invoices, Article 88 par. 3a (2) of the VAT shall not apply to the lessees, and they shall retain the right to deduct the input tax.

PIT

The Constitutional Tribunal, in the judgment of 18 July 2013 (file SK 18/09), held that some regulations on taxation of income from undisclosed sources were non-compliant with the Constitution.

The CT resolved that the non-compliance applied to Article 68 §4 of the PIT Act, which provided for the expiration period of the tax due on income from undisclosed sources, as well as Article 20 par. 3 of the PIT Act in the wording in force until 31 December 2006, which unclearly defined certain notions of key significance for the regulation. The TC considered the provisions as not conforming to legislative standards. The wording of Article 68 §4 of the PIT Act leads to a situation where the period of expiration of the tax due on income from undisclosed sources starts on multiple dates, and thus it may significantly exceed the general periods of expiration of taxes due. The CT assessed the situation as non-compliant with the principle of a democratic state of law (Article 2 of the Constitution), as this is the principle underlying the mechanism of expiration. The provision of Article 68 §4 of the PIT Act will become invalid 18 months after the date of the judgment publication, which means that from that moment, unless the legislator implements other regulations, the expiration period for a tax due on income from undisclosed sources shall commence, subject to general rules. The fact of legal regulations being considered non-compliant with the Constitution offers the taxpayers with respect to whom the relevant decisions were issued the possibility to demand that the tax procedure be re-opened and the case re-considered with the exclusion of the

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non-constitutional regulations. An application in this respect can be filed within one month of the CT verdict entry in force, i.e. within one month of its promulgation in the Journal of Laws.

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

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