

TAX NEWSLETTER

Issue 35 – March 2013



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SUMMARY

- **CIT:** A dividend in kind does not require the paying party to report income
- **VAT:** A foreign branch has the right to deduct VAT on expenses incurred for the purchase of goods and services related to the provision of guarantee services for a parent entity
- **VAT:** Publication of the judgment in the case of BGŻ Leasing (C-224/11) in the Official Journal of the EU
- **Transfer pricing:** Analysis of settlements with related parties and verification of documentation limits
- **PIT:** Classification of partnership income derived from securities trading

INTRODUCTION

Dear Sirs,

In the current issue of our Newsletter we comment on recent judgments relating to selected tax issues. We focus in particular on the judgment as to the payment of in-kind dividends and the approach of the Supreme Administrative Court to the right to deduct VAT by a foreign branch in Poland in reference to services provided for the parent entity.

We also encourage you to read other articles.

Yours faithfully,

Krystyna Szydłowska

CIT:

- A dividend in kind does not require the paying party to report income

The transfer of dividend in kind can be a very useful tool allowing in many cases a significant simplification of restructuring processes.

Despite the fact that the release of a thing or right in lieu of cash payment seems a relatively simple solution it raises some doubts both from legal and tax perspective.

Both the Minister of Finance in its interpretations and tax authorities in their decisions attempted to interpret the payment of in-kind dividend as a two-stage process: sale of a thing or right to the shareholder and setoff of the obligation to pay dividend against sales receivables. Such interpretation imposed the obligation of reporting income on the payer of dividend due to the sale of a thing or right.

The approach of tax administration was widely criticized because it did not take into account the Civil Code provisions (Article 453) with regard to “datio in solutum”. It also attributed to taxpayers actions and declarations that they have not taken and submitted – declaration about setoff.

Doubts as to the tax treatment of the discussed option were removed by the Supreme Administrative Court of 8 February 2013 ref. no. II FSK 1384/10, in which it stated that in the analysed situation no income for the payer of dividend is generated. This judgment is undoubtedly favourable to taxpayers and will enable them to apply this solution more widely in planning tax optimization in particular as regards the sale of real

estate and revaluation (marketization) of the initial value of fixed assets.

VAT:

- A foreign branch has the right to deduct VAT on expenses incurred for the purchase of goods and services related to the provision of guarantee services for a parent entity

In its judgment of 26 February 2013 (ref. I FSK 493/12) the Supreme Administrative Court (NSA) dismissed the cassation complaint of the Minister of Finance by saying that a foreign branch of a parent entity, operating in Poland has the right to deduct VAT if it provides guarantee services for the clients of the parent entity and its own clients and these services are fully reimbursed by the parent entity.

According to the court in the discussed case there is certainly a link between guarantee services provided by the foreign branch for the parent entity and the sale of final products by the concern in Poland and abroad (i.e. activities subject to VAT), therefore the assumption that the branch does not have the right to deduct VAT in reference to purchases related to the provision of guarantee services for the parent entity due to the intercompany character of these services would lead to violation of the VAT neutrality principle.

- Publication of the judgment in the case of BGŻ Leasing (C-224/11) in the Official Journal of the EU

On 17 January 2013 the Court of Justice of the European Union (CJEU) delivered a judgment regarding the possibility of treating the insurance of the leased item for VAT purposes as a distinct service independent from the lease contract itself and possibility of applying VAT exemption to the insurance services re-invoiced to lessees by lessors.

According to the Court of Justice the leasing and insurance service do not constitute, as a matter of principle, a single composite service subject to VAT at the basic rate (currently 23%). As a result, the CJEU considered that if the lessor takes out insurance on the subject matter of the leasing service and re-invoices the cost of insurance to the lessee, this type of insurance service provided to the lessee is exempt from VAT.

The publication of the CJEU judgment in the Official Journal of the EU was made on 2 March 2013. The date of publication can be of great practical importance for the Polish taxpayers.

First of all, the lessors with regard to whom the final decision challenging the application of VAT exemption to the re-invoicing of insurance was delivered are now allowed to re-open the tax proceedings. The basis for re-opening of the proceedings is in this case only the request of the parties filed within one month after the date of publication of the judgment in the Official Journal of the EU. As the publication was made on 2 March, the deadline is 2 April 2013.

Then, lessors, who for prudence reasons calculated VAT on re-invoiced insurance of the leased item, are entitled to apply for return of overpaid tax. If the taxpayer applies for tax return within 30 days after the publication of judgment, they will have the right to interest rate from the moment of overpayment recognition until the date of tax return. If the application is submitted later, the interest rate will be due from the date when tax overpayment was recognized until the 30th day after the publication of judgment.

On the other hand, the above judgment may have negative consequences for the clients of lessors. There is a risk that tax authorities will call into question the deduction of VAT on insurance, which constitutes an exempt service in line with the CJEU judgment.

In our opinion, the above risk is limited. It results from the fact that in accordance with general principles of Community law a taxpayer cannot bear negative consequences of Member States' defaults on implementation of EU provisions in national legislation or interpretation of Community regulations. As a result, we consider that there are convincing arguments to assume that the analysed judgment does not oblige lessees to adjust input VAT which was deducted from insurance services re-invoiced by the lessor.

Transfer pricing:

- Analysis of settlements with related parties and verification of documentation limits

March is a period of intensive work for financial and accounting departments of CIT payers whose tax year corresponds to calendar year. By the end of the month they are obliged to make the annual CIT settlements and file CIT-8 declarations. At the same time works on preparations of financial statements for the past year are in progress. This is the best moment to have a closer look at settlements with related parties in the last year especially in order to verify quantity limits resulting in a documentation obligation.

In practice, in case of tax controls in the companies being part of international groups, transfer pricing documentation is usually one of the first documents that the controllers require. Therefore, it is worth verifying in advance whether the transfer pricing documentation is complete and covers all settlements made in the given period and whether their value reaches the limit, which make them subject to documentation obligation. In practice, transaction grouping and their assessment in terms of limits defined in the CIT Act turn to be difficult, which is evidenced by several interpretations and judgments of administrative courts on this matter.

For this reason we would like to draw your attention to the most recent judgment in this area, i.e. a legally binding judgment of the Supreme Administrative Court in Warsaw of 15 January 2013 (ref. II FSK 1052/11). The Court supported the opinion presented in the interpretations received by the interested companies by saying that documentation limits specified in article 9a of the CIT Act should be applied to the sum total of all transactions of the same type conducted with a given entity in the tax year and not as the taxpayers suggest – each time to distinct services for which distinct prices were determined.

The above interpretation of regulations issued by the tax authorities and courts is in line with the interpretation that treating separately every service of a similar nature, e.g. business support services in various areas, could lead to omission of the regulations on the obligation of documenting transactions with related parties by distinguishing every service and a distinct fee for this service, and as a result, as well as to avoidance of control whether the applied transfer prices comply with arm's length principle.

The above judgment confirmed also the approach to documentation of re-invoiced services by considering that the resale (supported by invoice) of a formerly acquired service to a related party on a profit-free basis constitutes in fact a sale / provision of services for the related party and therefore is not free from the obligation of preparing tax documentation if the condition specified in article 9a paragraph 2 subparagraph 2 of the CIT Act is met (i.e. documentation limits were exceeded, in this case the equivalent of EUR 30 thousand).

Considering that settlements arising from cooperation and support agreements between related parties and settlements relating to re-invoicing the costs of purchase of services from independent entities are

very frequently made by related parties, we recommend analysing the settlements made and verify the documentation obligation in reference to this type of settlements/ services received, in particular in the light of the prevailing jurisprudence such as the judgment of the Voivodship Administrative Court in Warsaw of 9 February 2012 (ref. III SA/Wa 1506/11) and of 25 July 2012 (ref. III SA/Wa 2659/11, not final), and the judgment of the Supreme Administrative Court of 10 May 2012 (ref. II FSK 1893/10).

PIT:

- **Classification of partnership income derived from securities trading**

For individual taxpayers earning income from share in partnerships (among other limited partnerships or partnership limited by shares) the classification of profits from trading of securities may prove problematic.

Following the provisions of the PIT Act the income from sale of securities and derivative instruments and execution of resulting rights is excluded from the source being capital gains when the main activity is trading in such instruments.

At the same time, according to tax authorities and the majority of administrative courts, in the case of partnerships for which securities trading is an occasional activity and whose partners are individuals, the income from sale of financial instruments does not constitute business income. Such individuals should disclose profits from securities trading as capital gains in the PIT-38 declaration, i.e. separately from business income.



In the most recent judgment of 6 March 2013 the Supreme Administrative Court (II FSK 1364/11) stated that if securities' trading is entered into register as one of the business activities of the partnership, the income from securities trading should be classified as business income. However, if such trading is only "occasional" and is outside the scope of activity specified in the deed and in the records, income from securities trading should be classified as capital gains forming a distinct source of income.

It is difficult to say whether the above judgment will contribute to application of clearer criteria by tax authorities for qualification of capital gains earned through partnerships. It has to be expected that tax authorities will continue to prove that despite the entry of securities trading in the scope of activity, if this trading does not constitute the main business undertaking of the partnership, income derived from securities trading will not be qualified as business income for tax purposes.

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