

Tax Newsletter



NEWSLETTER | Issue # 14 – April 2011

Dear Sir or Madam,

In this issue I especially recommend the discussion of the most important changes in VAT, effective as of 1 April 2011 (i.e. changes concerning the gratuitous transfer of goods, re invoicing medical services, etc.). Particular attention is devoted to VAT changes relating to the taxation of scrap trading – a lack of definition of scrap may give rise to practical problems. In the next issues we will be returning to the topic of 2011 VAT changes from the practical point of view.

Traditionally, we present what we consider the most important recent

decisions of tax authorities and administrative courts, e.g. confirming that there is no requirement to prepare transfer pricing documentation for cash-pool transactions between related entities, with the participation of a bank.

We hope you will enjoy the newsletter!

I would also like to use this opportunity to invite you to a Tax Conference organised by Mazars on 18 May 2011: Withholding Tax – selected practical aspects. Information on the programme and participation terms will be sent to you separately.

Krystyna Szydłowska

EDITORIAL

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VAT – Discussion of changes effective as of 1 April 2011

On 1 April this year another amendment to the VAT regulations came into force. The most important changes are presented below.

Gratuitous transfer of goods

Now the gratuitous transfer of goods will be also taxed if it is related to the taxpayer's business activity, i.e. if it is performed for the purposes of advertising, promotions, bonuses, demonstrations, etc. Taxpayers will therefore need to issue internal invoices much more frequently (until now, in accordance with the decisions of administrative courts, gratuitous transfer was subject to taxation only in the case of goods given out for purposes not related with the conducted business activity, if the taxpayer was entitled to deduct the input tax).

Samples, gifts of small value and printed advertising materials will remain untaxed – as an exception to the general rule.

Gratuitous provision of services

In this regard the amendment is also unfavourable for the taxpayers. Now, in the case of a gratuitous provision of services for purposes other than connected with the conducted business activity (other than the use of goods being a part of the taxpayer's enterprise), an internal invoice should be also issued if the taxpayer was not entitled to deduct input tax. This means that **in almost every case where the employer purchases a third-party service for the benefit of an employee (e.g. swimming pool passes), such a service will need to be taxed by the taxpayer as gratuitous.**

Changes relating to the taxation of scrap trading

In principle, the tax on goods and services in this case will be charged not by the seller, but by the buyer of scrap (if the transaction is concluded between VAT payers). For more information on this topic see the article on page 4.

Reinvoicing medical services

The aim of the amendment in this respect was to clear the doubts that taxpayers have had since the beginning of the year when new regulations came into force, specifying in a new manner the scope of tax-exempt services, including medical services.

In principle, only those entities that performed these services directly (health care centres, doctors, etc.) were entitled to tax exemption. In the case of reinvoicing this type of services to another entity, tax exemption was not available. **Currently, the tax exemption also covers the provision of medical services, provided that these services were purchased by the taxpayer on his own behalf, but for the benefit of a third party, from health care centres and doctors.** The amendment came into force on 1 April this year, but with the right to apply it in the period from 1 January 2011 to 31 March 2011 (i.e. with retroactive effect).

The scope of tax-exempt services has also been extended and now includes services provided for the benefit of health care centres in their territory.

Import of goods

Taxpayers will be able to use more often the **simplified goods import settlement procedure** which consists in revealing the output tax due on that account in an ordinary VAT return and at the same time deducting this amount, i.e. without reporting it to the customs office. Previously this method of settling tax on import of goods was also possible, but taxpayers who wanted to use it had to pay a security deposit to the customs office in the amount of the output VAT. Now this condition has been abandoned.

Permanent place of business

Important changes relate also to the settlement of import of services and purchase of goods from foreign taxpayers. Previously, in most cases, **if the foreign entity was registered in Poland as a VAT payer, it could issue Polish VAT invoices with the output tax (if the services were provided in Poland). Since 1 April this year such a possibility has been limited to services connected with real estate.** In other cases, if the foreign taxpayer has no permanent place of business in Poland (related to the services it provides), it cannot issue invoices with output VAT, even if it is registered in Poland. If the purchaser receives such an invoice, it is not entitled to deduct the input tax.

Settling proportions

Some changes in this respect (the possibility of choosing to deduct the whole VAT amount or no such entitlement if the proportion exceeds 98% or does not exceed 2%) will apply only starting from the settlement for 2011, i.e. in 2012.

VAT - Changes relating to the taxation of scrap trading

Under the new VAT regulations, effective as of 1 April 2011, the taxpayer on account of purchasing scrap will be its recipient – a VAT payer (provided that the supply itself is not exempt from VAT and the supplier will be a VAT payer not using an exemption).

This regulation is an implementation of Article 199(1)(d) of Directive 112, according to which for some specified goods and services Member States may provide that the person liable for payment of VAT is the taxpayer – their recipient.

The taxation of the recipient, i.e. a mechanism called „reverse charge”, can be used for: the supply of used material, used material which cannot be re-used in the same state, scrap, industrial and non-industrial waste, recyclable waste, part processed waste and certain goods and services, as listed in Annex VI to Directive 112, that is:

1. supply of ferrous and non-ferrous waste, scrap, and used materials including that of semi-finished products resulting from the processing, manufacturing or melting down of ferrous and non-ferrous metals and their alloys;
2. supply of ferrous and non-ferrous semi-processed products and certain associated processing services;
3. supply of residues and other recyclable materials consisting of ferrous and non-ferrous metals, their alloys, slag, ash, scale and industrial residues containing metals or their alloys and supply of selection, cutting, fragmenting and pressing services of these products;
4. supply of, and certain processing services relating to, ferrous and non-ferrous waste as well as parings, scrap, waste and used and recyclable material consisting of cullet, glass, paper, paperboard and board, rags, bone, leather, imitation leather, parchment, raw hides and skins, tendons and sinews, twine, cordage, rope, cables, rubber and plastic;
5. supply of the materials referred to in this annex after processing in the form of cleaning, polishing, selection, cutting, fragmenting, pressing or casting into ingots;
6. supply of scrap and waste from the working of base materials.

As can be seen, the scope of goods and services listed in Directive 112 for which the reverse charge mechanism can be applied, is quite broad. **Importantly, the Community legislator allowed Member States to limit the above-mentioned scope with respect to goods and services covered or the categories of suppliers or recipients to whom these measures apply (Article 199(2) of Directive 112).**

Apparently, the Polish legislator decided to use this option and introduced the reverse charge mechanism only for the supply of scrap. The problem is that, contrary to the VAT regulations currently in force, the newly introduced regulations do not indicate what kind of scrap is referred to. The dictionary definition of scrap may be of some help. According to the definition provided by the PWN Dictionary of the Polish Language, scrap consists of unnecessary, worn-out metal objects, vehicles, machines or post-production waste collected as recyclable materials. Types of scrap are also listed in PKWiU (Polish Classification of Products and Services), which can be used as an auxiliary reference, although the VAT Act makes no direct reference to the classification. According to PKWiU of 2008, scrap is all kinds of metal waste other than dangerous waste. Moreover: bulk

glass, in the form of balls, bars or tubes, non-processed and glass waste. To determine the scope of the term “waste”, the ordinance of the Minister of Environment on the catalogue of waste can be used.

It seems, therefore, that in accordance with one of the possible interpretations of the term “scrap” for VAT taxing, scrap can be defined as, for example: broken-down vehicles, machines, waste containing metal but not containing fluids and other dangerous elements. On the other hand, the following types of waste will not be scrap: leather, rubber, plastic, or broken-down vehicles, batteries and other electrical devices containing dangerous substances. In practice, however, it is not difficult to imagine a situation where somebody considers a machine to be scrap (as it is unnecessary, worn out, etc.), while somebody else considers it to be a fully functional fixed asset after a small repair/alteration.

From the above it can be seen that a lack of definition of scrap in the VAT Act can lead to significant interpretation differences and, in consequence, to difficulties in determining the tax in the case of certain transactions. Disregarding the assessment of the introduced changes, it seems that the only remedy in this case is to have one's stand confirmed by obtaining an individual interpretation of VAT regulations in this respect.

CIT – Costs connected with purchasing shares

Many entrepreneurs take out a credit or loan to finance the transaction of buying shares of other companies. Taking into consideration specific provisions with respect to the settlement of costs relating to the purchase of shares as well as interest on loans/credits, taxpayers should pay particular attention to the moment in which they were incurred.

Pursuant to Article 16 sec. 1 point 8 of the Corporate Income Tax Act, expenses incurred for receiving or purchasing shares in a company are not considered tax-deductible costs; these expenses are, however, a tax-deductible cost if the above-mentioned shares are disposed of for consideration. This means that a taxpayer may include expenses incurred for purchasing shares as tax-deductible costs only after they are sold. In most interpretations of tax authorities and decisions of administrative courts the prevalent opinion is that the above-mentioned expenses should be understood as costs without which the valid purchase of these shares would not have been possible. They include in particular: the price for the shares, notary's fees, stamp duty, broker's commission. Costs of interest on a credit/loan, though indirectly connected with purchasing the shares, are not a necessary condition of their valid purchase. In the case described above, interest will constitute the cost of raising capital for purchasing shares.

It should be pointed out that the legislator has provided for a specific moment in which interest is included in the tax-deductible costs. **Interest does not always need to be a tax-deductible cost.** Pursuant to Article 16 sec. 1 points 10 and 11 of the Corporate Income Tax Act, interest may be classified as tax-deductible expense when they are capitalised or paid. Accrued interest which has not been paid yet (was not capitalised earlier) do not constitute a tax-deductible cost.

The views presented above were also confirmed by the Head of the Tax Chamber in Warsaw in the interpretation of 16 February 2011, ref. no. IPPB3/423-855/10-4/JB, where the authority

overruled the previous justification and decided that the company's point of view is valid. Below we present the most important theses contained in that interpretation:

“... interest on a loan for purchasing shares constitutes an expense for raising capital and as such have no direct connection with the purchase of shares, and are not classified as an expense incurred for receiving or purchasing shares”

“... the Company should classify interest on the loan for purchasing shares of the Subsidiary as a tax-deductible cost at the moment of its payment/capitalisation.”

The interpretation of the Head of the Tax Chamber in Warsaw presented above should be considered positive, as it reinforces the fairly consistent jurisdiction approach and provides accurate guidelines for classifying the expenses in question as tax-deductible costs.

Transfer pricing – Cash-pooling

Consistent approach of tax authorities to cash-pooling

Recently issued tax interpretations confirm the consistent approach of tax authorities with regard to cash-pooling, according to which **companies from a corporate group are not obligated to prepare transfer pricing tax documentation referred to in Article 9a of the Corporate Income Tax Act (CITA) in connection with a concluded cash-pooling agreement.**

Cash-pooling agreements used for effective management of financial liquidity of the whole corporate group are becoming more and more common, which can be seen from the frequent requests for tax interpretations relating to this kind of transactions submitted to the Minister of Finance by Polish companies being parties to cash-pooling agreements. Doubts in this respect relate to, among others, the obligation to prepare tax documentation specified in Article 9a of the Corporate Income Tax Act, connected with transactions involving affiliates.

Tax interpretations issued with respect to the above present a consistent view that the documentation obligation following from Article 9a of CITA does not apply to cash-pooling agreements (see: interpretation of the Head of the Tax Chamber in Warsaw of 20 April 2010, ref. no. IPPB3/423-26/10-4/PD; interpretation of the Head of the Tax Chamber in Poznań of 20 September 2010, ref. no. ILBP3/423-561/10-7).

Tax authorities concur with the presented opinions that cash-pooling is a kind of agreement concluded between a Bank on one part and Participants (companies from a corporate group) on the other part. Consequently, they are not transactions concluded solely between entities from one corporate group, as an important role is played by the service provider – the Bank – being an independent (non-affiliated) entity.

Tax authorities argue that the cash-pooling service is a comprehensive financial product created by the Bank which does not only provide a technical platform for performing transfers between the Participants' accounts and the Agent's main account, but is also responsible for cash pooling, maintaining the bank accounts of individual Participants and

calculating interest on positive and negative balances of given accounts. The applied interest rate and any commission fees charged on account of the provided services are determined solely by the Bank – an independent entity.

Due to the fact that companies participating in the cash-pooling system are not affiliated with the Bank, the interest earned by the Participants on account of their participation in the system does not constitute a turnover from transactions concluded with affiliated entities, which means that the sufficient conditions for the obligation to prepare transfer pricing tax documentation are not met.

However, if within the framework of cash-pooling the Pool Leader provides financial agency services for other participants and receives remuneration from them on account of these services, and if at the same time it is affiliated with the given cash-pooling Participant, then the obligation to prepare tax documentation will arise in relation to the remuneration received from that Participant (provided that the amount of the Pool Leader's annual remuneration exceeds EUR 30 thousand). An example is the interpretation of the Head of the Tax Chamber in Warsaw of 16 November 2009, ref. no. IPPB3/423-520/09-5/AG).

The view presented above is confirmed by a number of interpretations issued in the previous years (e.g. the interpretation of the Head of the Tax Chamber in Warsaw of 18 December 2009, ref. no. IPPB3/423-640/09-3/PD; interpretation of the Head of the Tax Chamber in Warsaw of 10 July 2009, ref. no. ILBP3/423-229/09-4/MS).

PIT – Precedential decision of the Supreme Administrative Court

In its decision of 5 April 2011 (II FSK 2059/09), the Supreme Administrative Court adjudicated in favour of taxpayers an issue which has long raised many doubts, relating to the tax exemption of funds acquired from selling real estate.

According to the decision of the Supreme Administrative Court, the exemption from the real estate sales tax in the case of purchasing real estate in another EU country has been valid since 2004.

In the case of selling real property purchased before 31 December 2006, the provisions of the income tax act in the wording binding until the end of 2006 apply. According to these provisions, if real estate is sold before the lapse of five years, counting from the end of the year of purchase, the exemption from income tax is valid only if the revenue from the sales is used for purchasing another real estate. However, the exemption is limited to real estate located in the territory of Poland. Meanwhile, after the Polish accession to the European Union, taxpayers have invested in real estate located in other EU countries and claimed an exemption from income tax. The legislator extended the scope of the exemption for real estate purchased in other member states, but these regulations came into effect in 2009 and did not cover real estate purchased before the end of 2006.

In the case in question, the taxpayer purchased in July 2005 real estate in Warsaw, which he then sold two years later. The income from the transaction was used for purchasing real estate in

London. The taxpayer submitted an application for the interpretation of tax regulations, asking whether – taking into account the Community law – he has the right to use the exemption to which he would have been entitled if the income from the sales had been used for purchasing real estate in Poland. The authority did not agree with the taxpayer and ordered him to pay the tax. The taxpayer appealed against the interpretation and won.

Both the court of first instance and the Supreme Administrative Court agreed with the taxpayer's stand. The court pointed out that if national regulations make the right to use a tax exemption conditional on whether the given real estate is located in Poland or in another country, this can discourage taxpayers from purchasing real estate in another member state and, consequently, infringes the provisions on the freedom of movement and the freedom of establishment contained in the Treaty establishing the European Community. **The court indicated that starting from the 1 May 2004 taxpayers are entitled to directly invoke the provisions of the Community law if the national law is inconsistent with those provisions.** Courts and tax administration authorities are also entitled to refuse to apply the national law in the case of such a conflict. This means that the taxpayer had the right to use the exemption from the real estate sales tax in the case of real estate purchased before the end of 2006 also if he used the income for purchasing real estate in another member state.

Events

We invite you to themed breakfasts and seminars run by Mazars tax experts:

➡ **18 May 2011, 9:30 – 1:30, the office of Mazars in Warsaw, Piękna 18 Street**
Tax Conference - „Withholding tax – selected practical aspects”

More information and registration: Emilia Biała, e.biala@mazars.pl, tel. 22 25 55 200

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