

Tax Newsletter

Issue # 25 - April 2012



Dear Sirs,

We are pleased to present the April issue of Tax Newsletter. We recommend you to read the article concerning the VAT treatment of transfer of enterprise without real property in the light of recent CJEU judgment. We also discuss the approach to real estate tax on buildings and constructions intended for business activity - the taxpayer-unfriendly criterion of qualification is currently the ownership right and not business reality (e.g. lack of actual use of the building). Taking into account the growing number of tax capital groups we are glad to note the favourable judgment renouncing tax authorities the right to assess the VAT taxation basis for transactions concluded between companies of the tax capital group.

You will find the presentation of other topics in the issue. Enjoy your reading!

Yours sincerely,

Krystyna Szydłowska

SUMMARY

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1 VAT: Is the transfer of enterprise without real property subject to VAT?

The transfer of an enterprise (its organized part) with the exclusion of real property is not subject to VAT if the purchaser can pursue the activity of the transferor.

In principle the operation of transfer of enterprise (and since 1 December 2008 also its organized part) is not subject to VAT in line with article 6 section 1 of the VAT Act. This exemption is based on the option defined in article 19 of the VAT Directive no. 112 (and corresponding art. 5 par. of the Sixth VAT Directive), which says that if the transfer concerns the totality of taxpayer's assets or part thereof, Member States may consider that no supply of goods has taken place and therefore this action is not subject to VAT.

As the VAT Act does not give any definition of the term "enterprise", hence, according to the generally accepted view, the definition provided by the Civil Code is applied to determine what "enterprise" means. In accordance with article 55 of the Civil Code an enterprise is an organised set of intangible and tangible assets intended for carrying out business activity. The Civil Code enumerates examples of assets constituting an enterprise; however, this enumeration is not exhaustive. Therefore, it is the functional and organisational link between the particular elements of assets that is decisive for determining whether we deal with an enterprise or not. This means that **for the transferred assets to be considered as enterprise they must constitute an organised complex of rights, duties and things allowing to fulfil economic tasks attributable to enterprise.** Consequently, the exclusion of functionally significant components of an enterprise (without which the enterprise is unable to operate) will lead to a situation where no sale of enterprise takes place and such transaction will be subject to VAT at the rate relevant for particular elements of assets.

The VAT exemption of the transfer of enterprise (its organized part) raises numerous doubts as to the type of assets that must be transferred in order to consider that the criteria set out in article 6 paragraph 1 of the VAT Act are met in the case in question.

There was also a big controversy over the fact whether a business requiring real property to operate is eligible for VAT exemption in the case of transfer of enterprise (its organized part). As an example, in the individual interpretation of 13 October 2010 (ref. IPPP1-443-717/10-4/JL) the Director of Fiscal Chamber in Warsaw stated that if the ownership right to the property was excluded from the transferred set of assets; such set cannot be deemed an organized part of enterprise. It would be impossible to run an enterprise without office space. Similar conclusions were reached by the Voivodship Administrative Court in Bydgoszcz in its judgment of 28 May 2008 (ref. no I SA/Bd 135/08).

A different view on the transfer of enterprise without real property was expressed by the Supreme Administrative Court in its judgment of 10 March 2011 (ref. I FSK 1062/10). The Court considered unfounded the opinion of tax authorities that the transaction whose subject matter is an enterprise would always lead to recognition that the transferred elements lose the nature of enterprise in total if one element mentioned as an example in article 55 of the Civil Code is excluded. According to the adjudication panel, any operation whose subject matter is the enterprise takes place only if the subject matter of the operation covers those elements which allow the pursuit of business. However, please bear in mind that it is not possible to set any universal patterns or criteria in this respect.

The confirmation that the transfer of real property ownership (right to perpetual usufruct) to the purchaser of the enterprise is not a prerequisite for qualifying the transaction as a transfer of enterprise or its organized part is expressed in the judgment of CJEU of 10 November 2011 (ref. no. C-444/10). The case concerned a German VAT payer who sold the stock of goods along with equipment of the shop of which she was an owner and treated this sale as a transfer of enterprise not subject to VAT despite the fact that the transaction did not include the sale of premises in which the shop was located. The premises were immediately leased to the purchaser for indefinite period. In its judgment the Court stated that for activity that can be carried out without premises it is not necessary that the owner of the enterprise be at the same time the owner of the premises. Therefore, **in the situation when premises or**



real property do not have specific features necessary to carry out a specific activity (it is also possible to conduct this activity in another premises), giving access to the property is not in any way the condition of recognizing the transaction as transfer of enterprise.

The judgment of CJEU should be viewed as a positive one. In particular, it is important that the CJEU in yet another settlement of a case noted the economic aspect of the transaction of transfer of an enterprise or its organised part. Such interpretation of regulations is undoubtedly favourable to taxpayers as it confirms that the exclusion of certain elements of enterprise's assets does not cause automatically this transaction to be ineligible for VAT exemption set out in article 6 paragraph 1 of the VAT Act in the event of the transfer of an enterprise.

2 Real estate tax: Tax rate vs. technical condition of the building /construction

In accordance with the Act on local taxes and charges of 12 January 1991 (Journal of Laws 2010, No. 95, item 613; hereinafter: PLoKU), building or construction related to carrying out business activity is defined as any building or construction owned by an entrepreneur or other entity carrying out business activity.

They are taxable at rates defined for entrepreneurs unless the subject of taxation is not and cannot be used for carrying out business activity for technical reasons.

The Act does not give any definition of the term "technical reasons", however, it is generally admitted that the indicated exclusion consists in the condition of real estate which objectively makes it impossible to carry out business activity in it. As emphasised by Voivodship Administrative Court in Szczecin in its judgment of 28 April 2011 (ref. I SA/Sz 53/11) "it cannot be accepted that the proverbial *hole in the roof* causes that the building loses its character related to business activity and its taxation burden significantly decreases". So the **approach of court organs to qualification of technical reasons seems to be restrictive in practice.**

Moreover, the adjudication panel resolved that „Because the Act on local taxes and charges does not define the term "technical reasons" it has been admitted in the case law to date that this term denotes circumstances making impossible to use the premises for business activity which are of objective nature and constitute a permanent obstacle for running business activity. In the case of buildings, such exclusion occurs in certain situations e.g. collapse, issue of demolition order, which make it impossible to use them. Technical reasons must concern therefore the very subject of taxation.”

At present the only criterion deciding whether a given real estate is related to carrying out business activity is the ownership of entrepreneur. It is not crucial from the legislative point of view whether a given real estate is in fact used for carrying out business activity throughout the year or whether it is used for such activity at all. Furthermore, even the serious defects which do not definitively preclude the possibility of using the building in the business activity do not constitute "technical reasons" according to PLoKU.

This taxpayer-unfriendly view was confirmed, among others, by the above-quoted judgment of the Voivodship Administrative Court in Szczecin of 28 April 2011. In its judgment the Voivodship Administrative Court emphasises that **the fact of non-carrying out business activity in the premises in question has not impact on the tax amount.** According to the court, the definition of land/building/construction related to carrying out business activity (art. 1a paragraph 1 item 3 PLoKU) does not imply expressis verbis a condition of using such real property for purposes related to business activity, but the mere fact of ownership by the entrepreneur suffices. What follows is that the premises not used for business purposes in a given moment must be considered to be related to business activity and taxable in line with general rules without any exemptions.



3 International tax law: A protocol to the Double Taxation Avoidance Agreement with Cyprus was signed

The Ministry of Finance informed on its website that the Protocol amending the Double Taxation Avoidance Agreement dated 4 June 1992 with respect to taxes on income and capital between the Government of the Republic of Poland and Government of the Republic of Cyprus was signed in Nicosia on 22 March 2012.

We have already informed you about the planned amendments to the Double Taxation Avoidance Agreement with Cyprus (hereinafter "Agreement") last year in the September issue of our Tax Newsletter. Then the Ministry of Finance revealed to the public only the information about the range of planned amendments without specifying the contents of the protocol.

The recently disclosed contents of the protocol confirms that after its entry into force **Polish tax residents will not be allowed to deduct the so called fictional tax** (i.e. tax that could be levied by Cypriot authorities in line with the Agreement) **from output tax in Poland on income subject to Cypriot withholding tax** (interest, dividends and royalties). The tax actually paid in Cyprus will be subject to the same deduction from the Polish tax.

The Protocol assumes the amendment of article 16 of the Agreement governing the rules of taxation of directors as a result of which **the remuneration perceived by the directors will only be taxed at the their country of residence**. Therefore, Polish residents perceiving income as a result of fulfilling functions of directors in companies incorporated under Cyprus laws will pay the tax on this income only in Poland (this income will not be subject to withholding tax in Cyprus at all). By the same token these individuals will not be allowed to benefit from preferential taxation rules for this type of income in line with Cypriot regulations.

The Agreement was also extended by the full clause on information exchange in tax matters resulting from the implementation of article 26 of the OECD Model Tax Convention on Income and Capital.

The Protocol will become effective upon completion of the procedure of sending ratification notes i.e. upon receipt of the last ratification note

and voting on the act on ratification of the agreement by the Polish parliament. At present it is difficult to estimate when the ratification procedure will be completed.

4 International tax law: Implementation of EU regulation on the social security systems in Switzerland

A new EU regulation on the coordination of social security systems became effective in Switzerland on 1 April 2012

As of 1 April 2012 the Regulation of the European Parliament and of the Council (EC) no. 883/2004 on the coordination of social security systems came into force in Switzerland. Before this date the relationships with Switzerland were governed by the Regulation no. 1408/1971, which was applicable within European Union, in principle, until the end of April 2010.

Considering the above, one has to remember that when applying for certificate allowing the employee assigned to work in Switzerland to stay in the Polish social security system, the new regulation must be applied. A document confirming that an employee is subject to Polish social security during their assignment in Switzerland will be currently, in principle, the A1 form (applied until now exclusively to employees assigned to work within European Union), and not E101 certificate as was the case until now.

5 Transfer pricing: Tax capital group vs. VAT taxation

Tax authorities do not have the right to assess the VAT taxation basis in transactions carried out between companies from capital group.

In its judgement of 22 February 2012 (ref. no. III SA/Wa 1436/11) Voivodship Administrative Court in Warsaw pronounced that tax authorities do not have the right to assess the VAT taxation basis for transactions between companies belonging to the same tax capital group established under article 1a of the CIT Act.

The subject matter of complaint was the individual interpretation of the Minister of Finance in which the tax authority considered that, although



companies from capital group are allowed to apply transfer prices differing from market prices in line with the CIT Act and this is not subject to assessment by tax authorities, such privilege is not accorded by the VAT Act. Consequently the Minister of Finance stated that tax authorities will be empowered to assess the turnover of companies from tax capital group under article 32 of the VAT Act if the sale of goods between those companies will be carried out applying non-market prices.

The Voivodship Administrative Court in Warsaw considered the opinion of the Minister of Finance

to be incorrect and observed that the objective of introducing article 32 to the VAT Act was to prevent actions aiming at evading taxes or susceptible to tax evasion. Yet, in the situation when the CIT Act provisions allow the companies from tax capital group to fix prices differing from market prices in the mutual transactions, it is not founded to say that such action is aimed at evading taxes. **Therefore tax authorities will not have the right to assess turnover with this respect.** A similar view on analogical factual situation was presented by the Supreme Administrative Court in its judgment of 28 November 2011 (ref. no. I FSK 155/11).

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