December 2023

GWW

INTERNATIONAL TAXATION

OVERVIEW OF RULINGS AND INTERPRETATIONS – WINTER 2023 NEWSLETTER

Table of contents

List of abbreviations

WSA – voivodship administrative court
NSA – Supreme Administrative Court
KIS Director – Director of National Revenue Administration Information Centre
PIT Act – Personal Income Tax Act
CIT Act – Corporate Income Tax Act
DTT – Double taxation treaty
Withholding tax/WHT – Lump-sum income tax (Personal and Corporate Income Tax)

1. Benefit received form a foreign foundation as a dividend

The end of 2023 brought another settlement on the issue of the classification of a payment from a foreign foundation. The WSA again upheld the position that the term dividend, as used in the PIT Act, includes a cash or non-cash benefit received by the founder from a foreign foundation.

KIS Director: CFC regulations do not take dividends into account

In the factual situation of the case presented, the taxpayer planned to establish a foreign foundation. The foundation's income was primarily intended to be passive income (dividends, interest from the sale of shares). According to the taxpayer, considering the foundation as a Controlled Foreign Corporation (CFC), the tax base should be reduced by the value of payments to the founder. These payments should be considered dividends under the PIT Act. However, the KIS Director disagreed with the taxpayer's reasoning. The authority stated that when amending the CFC regulations, the legislator introduced a definition of the concept of the right to participate in profits, which also includes the right to receive cash and non-cash benefits by the founder or beneficiary of the foundation. However, this right was not added to the benefits defined as dividends under the PIT Act.

WSA: broad catalog of benefits recognized as dividends

The argumentation of KIS was challenged by the judgment of WSA in Poznań on November 14, 2023, case number I SA/Po 234/23. The WSA pointed out that due to the international nature of the concept of dividends, it is impossible to define the concept of dividends in a complete and exhaustive manner. However, considering the nature of the provisions of the PIT Act, it is not possible to assert that the concept of dividends should be limited solely to distributions from profits made by capital companies. **This would lead to double taxation** of disputed benefits in the case of a taxpayer generating income from the activities of a controlled foreign entity that is a foundation.

Continuation of the favorable judicial trend

The judgment of WSA continues the favorable trend for taxpayers in jurisprudence, according to which **payments from foreign trusts may be considered as dividends and deducted from the tax base** of Controlled Foreign Corporations (CFCs). The increasing consistency in the case law on this issue should serve as a signal to tax authorities that the previous position of KIS regarding the nature of payments from foreign foundations is incorrect.

2. Unfavorable taxation of income from a civil partnership on the side of a Polish family foundation

With the entry into force of the regulations concerning Polish family foundations, a question arose as to whether a family foundation can be a partner in a civil partnership and, if so, whether its profits from participating in this civil partnership are exempt from Corporate Income Tax (CIT). To clarify this matter, requests for individual interpretations began to be submitted to tax authorities.

According to tax authorities, the legislator, in Article 5(1)(3) of the Family Foundations Act, did not use the general term "partnership," which could potentially also include a civil partnership, but instead employed a more specific term, "commercial partnership," thereby narrowing the scope of entities covered by the provision. Consequently, engaging in economic activities by entering into a civil partnership agreement goes beyond the scope mentioned in Article 5(1)(3) of the law. As a result, **profits from a civil partnership are subject to taxation on the foundation's side at the rate of 25%.**

3. Inclusion of Polish Family Foundation in the tax-transparent structure of a foreign company

Polish family foundations, as part of their permissible economic activities, can participate in commercial partnerships based in Poland or abroad. However, there are exceptions to this general provision that have recently caught the attention of Polish tax authorities.

Joining to foreign tax-transparent company goes beyond the catalog of permissible economic activities of family foundation.

In a tax interpretation issued on October 18, 2023, under reference number 0114-KDIP2-1.4010.399.2023.2.KS, a family foundation was contemplating joining a commercial partnership based in Luxembourg, exclusively dedicated to capital investments. Notably, this Luxembourg partnership operates as a tax-transparent entity under Luxembourg law. The taxpayer's inquiry focused on the possibility of exempting the family foundation's income, derived from profits in the Luxembourg partnership, from CIT in Poland. This inquiry stemmed from the argument that such activities fall within the permissible scope of economic activities outlined in Article 5 of the Family Foundations Act.

According to the stance of KIS Director, a foreign tax-transparent company is not considered a commercial partnership or a similar entity as specified in the Family Foundations Act. This means that **being a partner in a foreign non-legal entity falls outside the scope of permissible economic activities for a foundation**. The argument put forth by the authority is that tax-transparent foreign entities do not align with the definition of a "commercial partnership." In explaining this stance, KIS Director emphasizes that if the legislator intended to include such entities in the statutory catalog, a more general term like "partnerships" would have been used instead of specifically mentioning "commercial partnerships."

The stance of KIS Director was reiterated in a tax interpretation dated November 24, 2023, reference number: 0111-KDIB1-2.4010.248.2023.2.EJ. In the given scenario, a family foundation was considering joining a tax-transparent company in the USA.

Necessity for administrative courts to take action

The justification provided by KIS Director stating that foreign non-legal personality companies are not considered commercial partnerships or entities of a similar nature, **does not deserve approval**. According to this reasoning, Polish personal companies, if tax-transparent, should also not be classified as commercial partnerships under the law. However, the tax authority applies the exclusion from permissible economic activities only to foreign companies. Consequently, one can anticipate the intervention of administrative courts to challenge and potentially overturn the current stance of the KIS Director.

4. Cash contributed to a Polish family foundation does not constitute deductible expenses in the event of the foundation's liquidation

KIS Director holds the view that cash contributed to a Polish family foundation do not constitute deductible expenses in the event of the foundation's liquidation. This stance is reflected in three tax interpretations issued in August (references: 0114-KDIP2-1.4010.210.2023.2.KS; 0111-KDIB1-2.4010.173.2023.1.DP, 0114-KDIP2-1.4010.149.2023.2.KS).

KIS: Tax Deductible Expenses apply only to goods or rights.

In the aforementioned tax interpretations, the taxpayers planned to establish Polish family foundations. As founders, they intended to contribute cash in Polish currency to the foundation

to cover the founder's fund, the value of which was specified in the foundation's statute. The dissolution of the foundation was planned upon achieving the statutory goal. The taxpayer inquired with the tax authority whether, at the time of the foundation's dissolution, the cash received by the foundation could be considered as tax deductible expenses that reduce the taxable base of the foundation for CIT taxation.

According to the authority, only components of property that, in the event of their paid transfer, could be classified by the founder as costs of obtaining income can be included as tax-deductible expenses. Examples of such components are items or rights. However, in the case of cash, inclusion as costs of obtaining income would not be possible. This is because **cash (regardless of whether it is allocated to the founder's fund or donated during the foundation's operation) cannot constitute the tax value** of the property contributed by the founder.

Exceptionally unfavorable interpretation of regulations challenged in the Voivodship Administrative Court (WSA)

The reasoning presented above by KIS Director carries extremely unfavorable tax consequences for Polish family foundations. Fortunately, this interpretation is being challenged by some administrative courts. The Voivodship Administrative Court (WSA) in Łódź, in a judgment dated November 28, 2023, case number I SA/Łd 768/23, disagreed with the Director of KIS's reasoning. **The court pointed out that adopting the authority's position would lead to double taxation** of cash that had already been subject to PIT tax. However, there are also court judgments supporting the stance of tax authorities (judgment of WSA in Łódź dated November 28, 2023, case number I SA/Łd 737/23). At this moment, it is challenging to predict how the interpretative line on this issue will ultimately shape up.

5. When disbursing benefits to beneficiaries, a family foundation cannot exclude the value of assets transferred to the foundation from the tax base

According to the position of KIS Director expressed in the interpretation dated July 19, 2023, reference number: 0111-KDIB2-2.4015.114.2023.3.MM, a Polish family foundation, when providing benefits to beneficiaries, will not have the right to exclude the value of assets transferred to the foundation from the tax base (income within the meaning of Article 24q(2) of the CIT Act). Such an option exists only in the case of the foundation's dissolution.

As per the authority's standpoint in accordance with Article 24q of the CIT Act, income tax is required to be paid on benefits provided or made accessible by the family foundation, directly or indirectly. These benefits, comprising property components such as cash, items, or rights, are transferred to the beneficiary or entrusted to the family foundation for the beneficiary's use, as outlined in the foundation's statute and beneficiary list, according to Article 2(2) of the Family Foundations Act.

The exclusion of the value of assets transferred to the foundation from the tax base is governed by Article 24q(3) of the CIT Act. However, as indicated by the authority, this provision applies only to situations involving the transfer of assets in connection with the dissolution of the

foundation. The CIT Act does not provide for a reduction in the foundation's income in the case of benefits paid to a beneficiary from the funds transferred to the foundation by the founder.

KIS Director explains that benefits referred to in Article 2(2) of the Family Foundations Act are taxed according to specific rules, and the general provision of Article 12(1) of the CIT Act does not apply in this context.

6. When paying dividends to a foreign company, is it necessary for the payer to verify the tax status of that company, i.e., whether it is the actual beneficiary of the received dividends?

Judgment of the Supreme Administrative Court (NSA) dated January 31, 2023, case number II FSK 1588/20.

A Polish company, when distributing dividends to a foreign entity, **should examine whether the payment of this benefit is subject to taxation at source in Poland – through WHT** (Withholding Tax). In principle, the tax on dividends earned from participation in the profits of Polish legal entities is determined at a rate of 19%. However, it may happen that income from dividends is exempt from income tax if statutorily defined conditions are met (Article 22(4) and subsequent provisions of the CIT Act).

A Polish company distributing dividends assumes the duties of a withholder, which include the collection of tax on the disbursed amounts and its remittance to the tax office. In a situation where a Polish company pays dividends to entity subject to taxation in a country other than Poland that belongs to the European Union or the European Economic Area, and the total amount of dividends in a given tax year does not exceed PLN 2,000,000, it **may be exempt from tax**. However, to apply the exemption – in addition to a valid residence certificate – the Polish company should obtain a written declaration from the foreign entity stating that the conditions for applying the exemption to the disbursed amounts (dividends) have been met.

If, however, the total amount of disbursed amounts to a single foreign entity in a given tax year exceeds PLN 2,000,000, the exemption will apply only to that amount. Any excess beyond this threshold will be subject to taxation at a 19% WHT rate, which the Polish company is obligated to collect upon payment. However, it is **possible to exempt this excess** from taxation if the Polish company:

- possesses the documents required by tax law for applying the tax rate or exemption, or not collecting tax, as stipulated by specific provisions or double taxation avoidance agreements;
- lacks knowledge that would justify the presumption that circumstances exist excluding the possibility of applying the tax rate or exemption, or not collecting tax, as stipulated by specific provisions or double taxation avoidance agreements.

However, the key to the possibility of applying the WHT exemption is to examine the foreign entity to determine whether it is the actual beneficiary of the amounts received. This examination is to be carried out by the payer disbursing the amounts.

Regarding the obligations imposed on the payer in terms of applying exemptions to the amounts it disburses, the NSA expressed its opinion in a judgment dated January 31, 2023, case number II FSK 1588/20. The court stated, first and foremost, that imposing an obligation on the payer distributing dividends to verify the taxpayer's status **is the implementation of the function of preventing abuse of provisions aimed at eliminating double taxation**. This duty is not, therefore, an excessive burden on the payer in the context of the principle of proportionality.

In this regard, the NSA referred to the case law of the CJEU (judgments of February 26, 2019, in cases C-116/16 and C-117/16), as exemptions from taxation for the payments mentioned above arise from EU regulations. Emphasis is placed on the **due diligence that the payer should exercise in determining the status of the payee as the actual beneficiary**.

Regarding the obligations imposed on the payer, the NSA states that it is reasonable to **require the payer to verify the status of the dividend recipient**, i.e., to determine whether they are its actual owner. The verification of this status should be conducted with due diligence, taking into account the payer's capabilities in this regard, which does not imply an obligation to conduct proceedings like tax authorities. In exercising due diligence, the payer must determine whether there are grounds to refuse the application of the exemption (directive) or the preferential rate arising from the double taxation avoidance agreement.

Importantly, the burden of proof is **distributed between the payer and the tax authority** in such a way that the payer, acting with due diligence, is responsible for verifying whether the dividend recipient is its actual owner. In a situation where the tax authority questions the result of this verification, it **must prove that the dividend recipient is not its actual owner**.

Contact our team

Aldona Leszczyńska-Mikulska

Attorney-at-law, partner at GWW

Aldona.Leszczynska-Mikulska@gww.pl

Tomasz Piejak

Attorney-at-law, senior associate at GWW

Tomasz.Piejak @gww.pl

Natalia Uchmanowicz

Attorney-at-law, associate at GWW

Natalia.Uchmanowicz @gww.pl

Michał Zieliński

Attorney-at-law trainee, associate at GWW

Michal.Zielinski @gww.pl

Kacper Skałkowski

lawyer at GWW

Kacper.Skalkowski @gww.pl

Jakub Dziadur

lawyer at GWW

Jakub.Dziadur @gww.pl