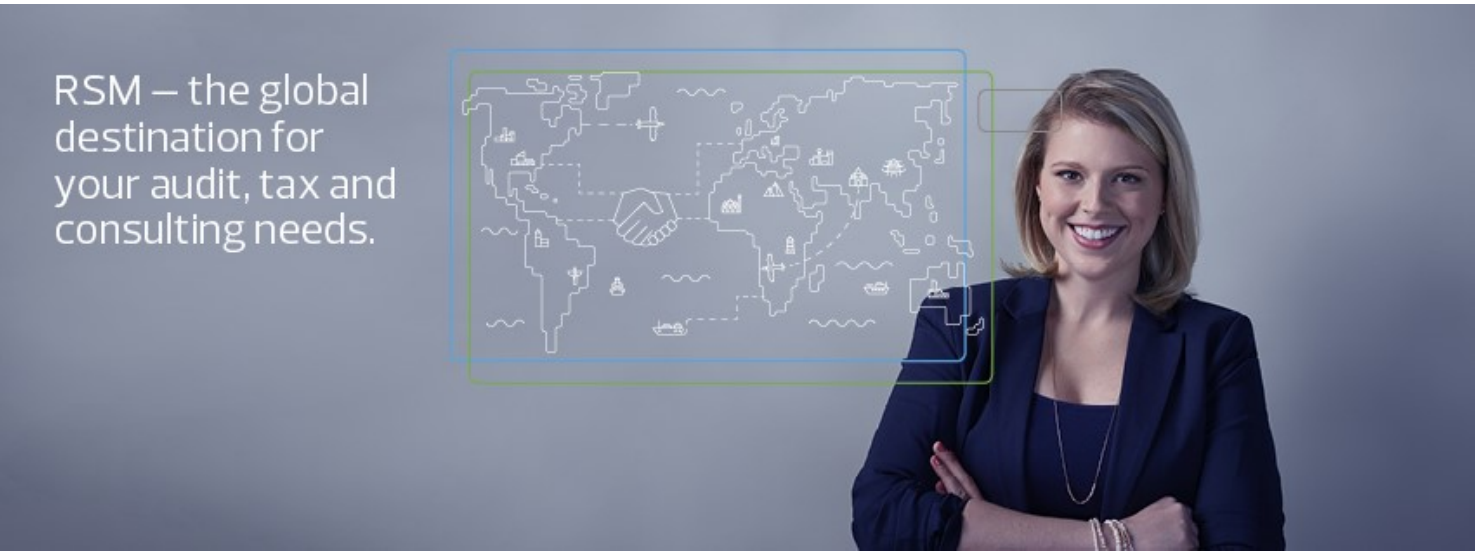

Transformation of a Company into a Partnership and Tax Costs from Depreciation

Tax Alert

Dear Readers,

After the transformation of a company into a partnership, partners are allowed to include all the depreciation charges that were also made on that part of the opening balance that was included in surplus capital in tax deductible expenses. This stand is confirmed by the Supreme Administrative Court in its latest judgment dated 9 August 2016, File No. II FSK 1717/14. This is another judgment by a court of cassation that is favorable to taxpayers.

Taxpayer's Inquiry
The case applied to a taxpayer who wondered whether, as a future partner in a partnership, he/ she would have the right to include all the depreciation charges attributable to him/ her and made on tangible fixed assets (real estate) and intangible fixed assets (trademark) in tax costs and, thus, made on that part of their opening balance that was included in a company (before being transformed into a partnership) in surplus capital (agio) and, thereby, that was subject to the restrictions defined in Article 16, section 1, clause 63 d of the Corporate Income Tax Act (hereinafter referred to as the "CITA"). The Article envisages that tax deductible expenses are not recognized as depreciation charges on the opening balance of the tangible fixed assets and intangible fixed assets acquired in the form of a contribution in kind, on that part of the balance that was not allocated for the issuing or increasing the company's share capital.

Stand By Administrative Courts
In the opinion of WSA (The Provincial Administrative Court), the provisions of the aforementioned Article will not apply to the case in question, since they refer only to a company. The Court explained that despite the fact that under Article 93a, § 2, clause 1b of the Tax Ordinance (hereinafter referred to as the "TO") a transformed partnership enters into all the rights and obligations of a company being transformed (the so-called general succession), this regulation under Article 93e of the TO should be applied unless otherwise stated by separate Acts. The issue of continuation of the depreciation rules in the case of transformation is governed by Article 16g, section 9 of the Corporate Income Tax Act. Pursuant to the provisions of the said Article, when a legal form is transformed, the opening balances of the tangible fixed assets and intangible fixed assets will be established as the opening balances posted in the Tangible and Intangible Fixed Assets Register by the entity being transformed The same rule applies to entities without legal personality (partnerships). Also, under Article 16h, section 3 of the CITA, any entity established as a result of transformation that took over all or part of another entity, due to transformation, will make depreciation charges in the amount of the previous depreciation charges and continue the depreciation method adopted by the company. The regulations mentioned above are detailed regulations in terms of continuation of depreciation rules, as opposed to the general succession rules

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under Article 93a of the TO referred to earlier above. Consequently, taking into account the fact that Article 93a does not address the issue of continued recognizing the depreciation charges as tax costs, it can be concluded that it does not exclude the possibility for a partner in a partnership (established as a result of the transformation of a company) to include them in tax costs also in that part that in the company was subject to restrictions defined by Article 16, section 1, clause 63d of the CITA. Thus, in the Court's view, there are no obstacles to a partner in a partnership including the full amount of depreciation charges in tax costs, i.e. also on that part of the opening balance that was in the surplus capital of a company.

The Supreme Administrative Court shared the view of the court of the first instance, noting that the issue of possible application of the said restrictions had already been resolved by the Supreme Administrative Court on 17 May 2016, File No. II FSK 1107/14, and on 4 November 2015, File No.II FSK 3013/13 and II FSK 3014/13. As in its previous judgments, in the case in question the Supreme Administrative Court decided that the exclusion from costs envisaged by Article 16, Section 1, Clause 63d of the CITA should apply only to companies and could not be transferred to a partner in a partnership, whether or not the partner is a natural or legal person. The Supreme Administrative Court gave the reasons for its judgment on the basis of earlier judgments in which a court of cassation stated that the application of the restrictions defined by Article 16, section 1, clause 63d of the CITA could not be derived from Article 93a, § 2, clause 1b of the TO. The court takes a stand that the above regulation governing the entering of a partnership which is established as a result of transformation of a company in all the rights and obligations of a person or company being transformed, as prescribed by the law, may not lead to a change of the legal regime which applies to partnerships and, more precisely, to partners in such partnerships. A company ceases to exist as a result of its transformation into a partnership. However, the legislator has not envisaged in this case the continuation of the said restrictions and, thus, they will not apply to the case in question.

Moreover, the court of cassation also noticed a different standpoint present in the judgments dated 12 January 2016, File No. II FSK 3279/13 and 11 February 2016, File No. 3356/13, but it does not share it. The judges deciding the case in question believe that an excessively broad scope of succession under the CITA was erroneously adopted in the issued judgments that is not true in the case of transformation of company into a partnership. Also, such articles as Article 15, section 6 of the CITA and Article 93a, §2, clause 1b of the TO were interpreted incorrectly.

Doubts Shared by Tax Authorities

The issue in question has for many years raised doubts among tax authorities that by referring to the general succession rule often refused to allow partners in a partnership established as a result of a transformation of a company to include all depreciation charges in tax costs, due to the restrictions stipulated by Article 16, section 1, clause 63d of the CITA. The tax authorities argued that since a company could not include a part of depreciation charges in the tax costs, then the partners in a partnership should not do it either.

Another important fact is that, despite the fact that there were no amendments to the regulations, the latest individual tax rulings show a change in the direction of the interpretation of the regulations by tax authorities that is favorable to taxpayers (for instance: the Head of Tax Chamber in Poznań on 15 June 2016, Ref. No. ILPB1/4511-1-533/16-3/AN, the Head of Tax Chamber in Łódź in April 2016, Ref. No. IPTPB1/4511-872/15-4/MM and Head of Tax Chamber in Poznań on 23 February 2016, Ref. No. ILPB1/4511-1-1660/15-2/AP).

To conclude, it is necessary to note that the transformation of a company into a partnership may be linked with achieving tax advantages since it will be possible to include depreciation charges in tax costs in full. The restrictions defined by Article 16, section 1, clause 63d of the CITA apply only to a company and they cannot be transferred to a partnership.

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Should you wish to discuss the above mentioned amendments in detail, feel free to contact us:

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