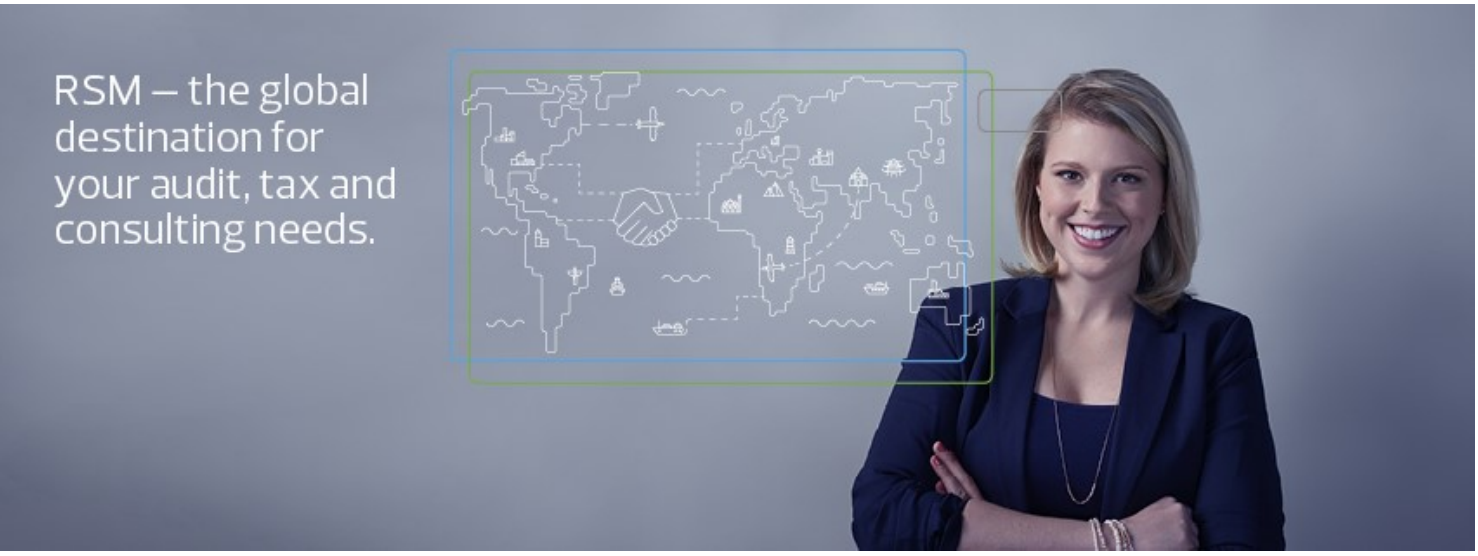

Not only the pool leader will pay a withholding tax on interest from a cash pooling agreement

Tax Alert

Dear Readers,

Recently, the Supreme Administrative Court (hereinafter the SAC) issued an unfavourable judgement for taxpayers concerning the taxation of so-called cash pooling. The SAC in its judgement of 16 September 2016, file ref. No. II FSK 2299/14, stated that the pool leader can not be regarded as the owner of all receivables paid to the group account, because it is not entitled to dispose of the interest in its sole discretion. The court emphasized that the possibility of a formal disposal of receivables is not the same as a real disposing. In this Tax Alert, we would like to present you the position approved by the Supreme Administrative Court.

The case concerns a company which intends to accede to the system of joint management of financial liquidity within a capital group (hereinafter referred to as cash pooling), to ensure optimal liquidity of all involved entities and reduce their borrowing costs. The technical side of the cash pooling operation will be managed by a foreign bank, which opened a group account as a basic account for an entity based in Norway, included in the capital group (i.e. the pool leader), which also owns the applicant company. The pool leader will engage its funds in a cash pooling system, but it will also manage this system. The company requested in its application for an individual interpretation of the question whether the taxation of interest payments made to the pool leader will apply art. 21 par. 3 of the Corporate Income Tax Act (hereinafter: CIT Act), as a result of which interest they shall be able to be exempt from withholding tax, and if not – whether the taxation of the interest will apply art. 11 of the Convention between the Kingdom of Norway and the Republic of Poland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed on 9 September 2009 (hereinafter as the Convention).

According to the Minister of Finance (hereinafter: the MF), the Company will be able to apply the exemption referred to in art. 21 par. 3 of the CIT Act only to the interest paid to the pool leader, who will be the actual recipient, i.e. the interest to which the pool leader will be entitled as a participant of the system. With regard to the possibility of applying the Convention, the MF explained that the provisions of the Convention apply only to entities that are the actual recipients of interest, whereas the pool leader is not the ultimate owner (beneficial owner) of all interest paid by the Company.

The Province Administrative Court in Gdańsk, in the grounds of its judgement, followed this position of the MF. The Court decided that if the Polish entity, acting in conditions specified by art. 26 par. 1 of the CIT Act, pays the debts (interest) to a resident of another state, which is not an entity entitled to the interest, the Polish company shall not be limited in the right to tax the interest in Poland. Therefore, the Company should first

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establish the taxpayer, which would receive the interest, and then in accordance to its place of residence, the Company should apply the provisions of the relevant agreement on the avoidance of double taxation, in order to determine the appropriate tax rate or waive the collection of the tax if the contract provides for such a possibility.

The above considerations were confirmed by the Supreme Administrative Court in its judgement. In this case, the key issue was to clarify the concept of "beneficial owner" in the context of art. 11 par. 2 of the Convention in relation to art. 21 par. 1 item 1 and par. 2 and art. 26 par. 1 of the CIT Act. The Supreme Administrative Court pointed out that in the absence of the definition of "beneficial owner" in the Convention, it is reasonable to refer to the meaning of this concept in civil law, but above all to the interpretative guidance contained in the OECD Model Convention for the avoidance of double taxation as the original of the convention and the official commentary to it. Therefore, based on these interpretative guidelines, the beneficial owner within the meaning of art. 11 par. 2 of the Convention should be an entity with a right to dispose of the interest (beneficial owner).

According to the SAC, the cash pooling agreement restricts the scope of the right to freely dispose of the funds by the pool leader, thus it eliminates the possibility of treating the pool leader as the actual beneficial owner. Therefore, the pool leader cannot be indicated as the beneficial owner, referred to in art. 11 of the Convention, in relation to all interest transferred to the group account, as it acts only as an intermediary and has no right to dispose of them at its own discretion.

The approach presented by the SAC in this case is confirmed in the earlier rulings of the SAC, including judgements of 11 June 2015, file ref. No. II FSK 1518/13, and of 2 March 2016, file ref. No. II FSK 3666/13.

The tax authorities and administrative courts agree that the pool leader can not be regarded as the owner of all receivables paid to the group account, because it is not entitled to dispose of the interest in its sole discretion. Therefore, the payer who wants to take advantage of the favourable tax solutions of art. 21 par. 3 of the CIT Act or art. 11 of the convention on the avoidance of double taxation, shall determine who is the real disposer of the interest in the cash pooling agreement.

Finally, it is worth noting that from 1 January 2017, under the Act of 5 September 2016 amending the Personal Income Tax Act and the Corporate Income Tax Act (Journal of Laws item 1550), art. 21 par. 3 item 4 of the CIT Act will include a provision according to which the recipient of receivables shall be the real owner (the "beneficial owner"). However, according to the new art. 4a par. 29 of the CIT Act, the real owner is the entity receiving a particular asset for its own benefit, which is not an intermediary, agent, trustee or other entity obliged to transfer all or part of the debt to another entity. This amendment will eliminate the existing discrepancies in interpretation and the new regulations will clearly indicate that the company receiving royalties and interest shall be the real owner ("beneficial owner").

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

Piotr LISS
Tax Partner
Tax advisor (10240)
E: piotr.liss@rsmpoland.pl
M: + 48 696 488 369

RSM Poland
Droga Dębińska 3b
61-555 Poznań, Poland
www.rsmpoland.pl
office@rsmpoland.pl

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