

INTRODUCTION OF SUBSTANCE OVER FORM PRINCIPLE INTO THE TAX LAW– NEW SOURCE OF TAX RISK FOR THE BUSINESS

On 14 June 2016 the Act from 13 May 2016 amending the Tax Ordinance and other acts (hereinafter referred to as the "Act") has been published in the Journal of Laws. It radically modifies clause on avoiding double taxation (hereinafter referred to as the "Clause").

Assumptions of the Act

The aim of the Act is to implement an item enabling the Ministry of Finance to ignore tax benefit resulting from legal acts contrary to the object and purpose of the tax regulations, made primarily in order to achieve a tax benefit.

Introducing the Clause is consistent with guidelines of EU and OECD.

When the Clause may be applicable

- In accordance with the Act, the Clause shall be applicable if an activity was undertaken primarily in order to achieve a tax benefit, remains contrary to the object and purpose of the tax regulations and undertaken activity is artificial (the following shall be taken under consideration:)
 - 1) unjustified division of operations;
 - 2) engagement of intermediation entities without economic justification
 - 3) elements which exclude or compensate themselves or other economic risks exceeding expected value, which otherwise would not have been concluded provided lack of economic justification)
- Provided that an activity is deemed as a tax evasion, it shall have the same tax result as an appropriate act. An appropriate act is considered as an act which would be undertaken by entity acting reasonably and guided by the objectives consistent with the law, but other than achieving the tax benefit.
- **An extended definition of tax advantage has been adopted** - i.e. non-existence of tax obligation, lowering the value of tax obligation, postponing date of payment, overestimating the loss, existence of repayment or overpayment of tax.

- The Clause shall be used, as a rule, for all national and local taxes; however it shall not affect fees and public liabilities. With respect to VAT, separate, similar to the main clause, regulations were implemented.

The burden of proving the circumstances allowing for application of the Clause will be imposed on the tax authorities. In other words, the tax authorities will check if the taxpayer acts in an artificial way, i.e. one that is not economically justified, or if economic reasons are sufficient.

Exemptions from the Clause

The Clause will not apply e.g. in the following cases:

- The tax gain or the sum of tax gains obtained by taxpayer exceeds PLN 100,0000
- If an entity has requested for a securing opinion from the Minister of Finance or
- The Clause shall not be used if double taxation agreements indicate so.

Consequences of recognition legal acts as evasion of tax

- Deprivation of tax benefit met or intended to achieve.
- If the result of this comes to disclosure of tax arrears, the taxpayer will be required to pay tax plus penalty interest.
- The Act does not provide any additional financial sanctions.

Who will apply the Clause?

An entity empowered to apply the Clause is the Minister of Finance.

Limitation of issuing the tax rulings and securing opinions

- In the Act it was proposed that taxpayer does not have a right to obtain a tax ruling if there is a justified suspicion that factual state to be covered by the tax ruling aims to evade taxation.
- With respect to the new regulations a taxpayer will be entitled to apply to the Ministry of Finance for a securing opinion.
- The opinion will costs PLN 20,000 and the Ministry has 6 months to issue.
- The application may relate to activities planned, initiated or undertaken.

- The application shall include inter alia a description of activities, objectives and economic and business reasons. The taxpayer will determine the effects and tax benefits, which will be the result of given activities and its position on the case.
- Taxpayers will have right to appeal from obtained, negative securing opinion to the Administrative Court

Changes in the value added tax (VAT)

As mentioned, the Act implements also regulations allowing for applying the substance over form principle on the grounds of VAT, which are similar to the Clause.

Entry into force

Few days before the end of works on the final version of the Act the significant and very unfavorable change from the view of taxpayers was introduced.

In the initial version of the Act, for determining the scope of application of the new regulations, the moment of performing the activity was important. In the final version the above described intertemporal provisions have been changed, now they read as follows:

“the Clause shall be applicable to tax gains acquired after entry into force of the Act”.

The above means that beneficial tax effects of the activity carried out by taxpayers undertaken before the entry into force of the Act, can now be challenged on the basis of the provisions of the Clause.

Mere fact of performing activity before the day of entry into force of the Act shall not preclude the application of the new rules.

In this case, if the tax benefit will take place after the entry into force of the Act, the tax authorities will be entitled to apply enacted legislation in relation to activities performed prior to the entry into force of the Act.

What do the changes mean for the business?

Implementation of the substance of the form principle means e.g. that:

- ways of achieving tax savings which have been applied so far should be verified.
- higher number of business projects should be analyzed from the perspective of triggering any potential tax risk.

Should you have any questions or need help in connection with this problem, we remain at your disposal.

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