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The Ministry of Finance is preparing explanations to withholding tax regulations

I. Later this year, the Ministry of Finance will issue explanations regarding withholding tax

The Ministry of Finance is conducting tax consultations on the draft tax explanations regarding withholding tax (WHT) regulations. The subject of the consultations is a draft tax explanation regarding the beneficial owner clause (BO clause), the criterion of being subject to effective taxation in relation to the provisions of EU directives and the look-through approach (LTA) concept. We would like to remind that regulations concerning the so-called pay & refund procedure were introduced into the Polish tax system on 1 January 2019. The obligation to collect withholding tax at the national rate after exceeding the PLN 2 million threshold for dividends, interest and license payments to the same related taxpayer, with the right to a full or partial refund of the collected tax, became effective on 1 January 2022.

II. All conditions must be met collectively to be considered a beneficial owner

The beneficial owner (BO) within the meaning of CIT regulations is an entity that meets all three conditions. Firstly, it receives a given receivable for its own benefit, decides on its purpose and bears the economic risk associated with the loss of this receivable or part thereof. Secondly, this entity is not an agent, representative, trustee or any other entity obliged to transfer the receivable in full or in part to another entity. And thirdly, this entity conducts actual business activity in the country of its registered office if the receivables are obtained in connection with the business activity conducted, and when assessing whether the entity conducts actual business activity, the nature and scale of the activity conducted by this entity in the scope of the received receivables must be taken into consideration.

III. The receivables administrator cannot be considered the beneficial owner

The explanations state that, taking into account the international tax significance of the BO concept, it must be assumed that the criterion (condition) of receiving receivables for one's own benefit and the lack of obligation to transfer the receivable to another entity should be considered together. In principle, they exclude entities that act as administrators of the income in relation to the receivable received from the BO definition. At the same time, the Ministry points out that it is not possible to create an exhaustive list of criteria (conditions) qualifying a given entity as an administrator of the income. The administrator of the income cannot be considered the beneficial owner because its right to dispose of the income is limited by the obligation to transfer the received amount to another entity.

As part of due diligence, the payer should verify the foreign contractor not only in terms of the status of the beneficial owner, but also assess whether the payment made to it or this entity itself meets the negative criteria (conditions) specified in CIT regulations excluding the possibility of applying tax exemptions - explained the Minister of Finance in the draft tax explanations regarding withholding tax (WHT) regulations.

IV. Transfer of income not always in the same form in which it was obtained

The explanations also included a clarification that the actual obligation is determined on the basis of all circumstances of the case. This criterion should be applied primarily to related entities. This criterion places emphasis on examining the economic substance of the intermediary entity or verifying the existence of an "enforceable obligation" to transfer the receivables, e.g. when the foreign company granting the sublicense does not have funds other than those received from the Polish payer for payment to the licensor from another jurisdiction for a license received from it. An intermediary company that continues to pay dividends due to the informal dividend policy of the capital group (i.e. without a contractual or legal obligation) may be considered obliged to transfer the receivables on the basis of a factual criterion. However, the obligation to transfer income does not always have to consist in transferring the income in the same form in which it was obtained. When considering whether there is an obligation to transfer income, it should be noted that this obligation must be specific to the payment received and closely related to it.

V. It is necessary to examine whether the activity is actually carried out

Referring to the criterion of conducting real business activity, the Minister of Finance explained that this criterion is not met by tax structures that are a wholly artificial arrangement or an artificial arrangement in part. The criterion of full artificiality should be considered primarily in the context of the case law of the Court of Justice of the European Union in the light of which this condition is met by fictitious companies that do not actually carry out any economic activity. Such an entity does not have any staff, headquarters or equipment. However, this concept gradually evolved, gaining greater flexibility (gradable nature). Thus, currently, having one or two employees does not mean that the criterion of artificiality is not met. In other words, verification of the requirement to conduct actual economic activity should not be limited only to checking the physical presence of such entities in other countries. In consequence, the fact that a holding company meets the minimum personal and property criteria provided for in the given jurisdiction does not automatically mean that the artificiality criterion is not met.

VI. Not only the activity but also the specific transaction must be real

Artificiality, in the light of the CJEU jurisprudence, occurs both when the entity used in the optimisation structure is artificial and when this entity is real, i.e. it conducts a real economic activity, but the specific transaction to which it is a party is artificial. If the recipient of the payment does not run an actual business activity, it is difficult to recognise that it is the beneficial owner of the payment and, in particular, that it could decide on the use of the funds obtained this way. On the other hand, the mere fact of conducting an actual business activity by such an entity is not a sufficient premise to recognise that it meets the conditions for being considered the beneficial owner of the given payment. Thus, as part of due diligence, the payer should verify the foreign contractor not only in terms of the status of the beneficial owner, but also assess whether the payment made to it or this entity itself meets the negative criteria (conditions) specified in CIT regulations excluding the possibility of applying tax exemptions.

VII. If there is no definition of the beneficial owner in the contract, the definition provided for in the Act on CIT applies

According to the Minister of Finance, it must be assumed that the term “beneficial owner” applies in the given double taxation agreement, regardless of whether it expressly includes such a clause in relation to dividends, interest or royalties. In consequence, there are no grounds to differentiate the payer's due diligence obligations by distinguishing between contracts containing and not containing an explicit reference to the concept of the beneficial owner. It must be assumed that for the purposes of applying the reduced withholding tax rate provided for in the given contract, it is justified to use the definition of the beneficial owner provided for in the Act on CIT. In the case of dividend pay-outs - as part of due diligence related to the possibility of applying the exemption - the Polish payer must verify the status of the beneficial owner of the recipient of such dividends.

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VIII. Applying the look-through approach (LTA) concept is exceptionally possible

The explanations state that application of the look-through approach concept (i.e. determining by the tax authority who is the beneficial owner of a receivable when the entity obtaining such a receivable is not its beneficial owner) is not justified by the provisions of the Act on CIT or the Act on PIT, nor in the provisions of the Tax Ordinance. As a result, tax authorities are not, in principle, obliged to apply this concept. The possibility of its application is basically limited only to cases where the following criteria are met: the use of an intermediary company between the payer's country and the country of the recipient of the receivable who is the beneficial owner does not result in a reduction of withholding tax collected in the payer's country; the payment type is the same in the relation payer - foreign intermediary company - foreign payment recipient being the beneficial owner; the entire structure or payment in question is not artificial.