

Restrictions on the use of the WHT participation exemption are increasing

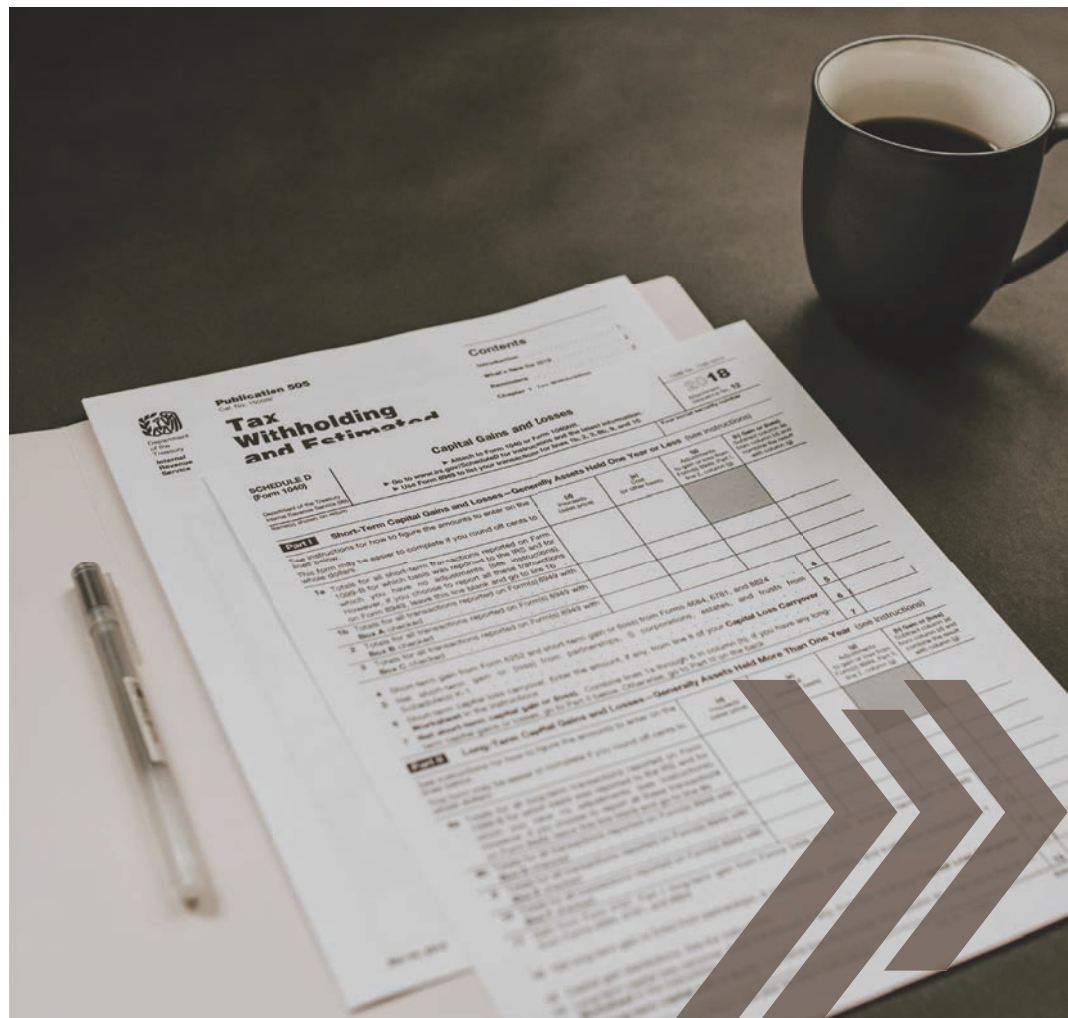
I. Administrative courts introduce new requirements regarding exemption from WHT

The latest case law regarding exemptions from withholding tax (WHT) indicates an increasingly stringent approach of courts and tax authorities in terms of meeting the conditions for effective taxation of the receivable recipient. Recently, courts have increasingly examined whether the recipient of dividends or other distributions is actually subject to income tax in their country of residence (hence, the exemption is referred to as the “participation exemption”). The analysis of this case law leads to the conclusion that it is clearly inconsistent with the literal wording of the Act on CIT and the Parent-Subsidiary Directive (Council Directive 2011/96/EU) as well as with the purposes for which the participation exemption was established.

The latest case law regarding participation exemptions from withholding tax (WHT) indicates an increasingly strict approach of courts and tax authorities in terms of meeting the conditions for effective taxation of the receivable recipient. This leads to an overinterpretation of the applicable regulations in relation to their literal wording.

II. The participation exemption is intended to guarantee the absence of double taxation

The participation exemption is a tax preference applicable to dividends paid between companies within the European Union. It is based on the so-called Parent-Subsidiary Directive (Council Directive 2011/96/EU) which aims to avoid double taxation of dividends. Thanks to this exemption, a parent company based in one EU member state can receive dividends from its subsidiary without having to pay withholding tax in the country where the dividends are paid. The participation exemption is, therefore, intended to eliminate double taxation of the same income - once at the level of the subsidiary and once at the level of the parent company.



III. The regulations exclude participation exemption only if there is no tax

To benefit from the participation exemption, certain conditions must be met. First of all, the parent company must hold a minimum percentage of shares in the capital of the subsidiary (for Poland, it is 10%) for a specified period of time (for Poland, it is 2 years). Regardless, in some cases the tax authority may check whether the recipient of the dividend (the parent company) is actually subject to effective taxation in its country of residence. In this context, the exemption will not apply if the parent company is not subject to tax in its home country or benefits from tax exemptions there. In this case, Polish regulations stipulate that the company cannot benefit from exemption from income tax on all of its income, regardless of the source of its achievement.

IV. The tax authorities and some courts strive to examine effective taxation

In the jurisprudence of Polish courts, the requirement for exemption from WHT (participation exemption) is the effective taxation of the recipient of the receivable with income tax. This is another requirement, in addition to the status of the beneficial owner of the recipient of receivables subject to WHT. These judgments indicate that the existence of the participation exemption (Article 22(4-6) of the Act on CIT) means that the receivables received are not subject to taxation in the country of tax residence of the parent company in a situation where most of the income of the given entity originates from receivables from subsidiaries. In such a case, the vast majority of this income will be exempt from taxation. The consequence of this is that the recipient of the receivable will not be subject to effective taxation and, thus, will not be able to demonstrate the grounds for not benefiting from the exemption from income tax on all of their income, regardless of the source of their income. Examples of such judgments include, without limitations: judgment of the Voivodeship Administrative Court in Lublin of 21 February 2024 (case file ref. no. I SA/Lu 654/23) or of 27 March 2024 (case file ref. no. I SA/Lu 724/23). It must be emphasised that there are more such judgments.



V. The interpretation of the courts land tax authorities is inconsistent with the wording of the regulations

The condition regarding effective taxation, which is required by some tax authorities and administrative courts, does not result directly from the provisions of the Act on CIT. Effective taxation is a concept that refers to the actual tax burden borne by an entity in the given country, and not just the formal requirement to pay tax. In the context of withholding tax (WHT) and participation exemption, this issue concerns checking whether the income obtained by a foreign recipient of a dividend or other income is actually subject to tax in their country of residence. In such a case, the practical challenge is to establish what criteria determine "effective" taxation. Meanwhile, literal interpretation of the regulations indicates that legal regulations, including EU directives, do not require such an analysis. The Parent-Subsidiary Directive focuses on eliminating double taxation, and not on checking whether the income is actually subject to taxation in the country of residence of the dividend recipient.



MAREK SPORNY
Senior Tax Manager
of Tax Department BDO,
office Poznań
+ 48 61 622 57 00
Marek.Sporny@bdo.pl



The information presented herein does not constitute comprehensive information or opinion. Consult your adviser before making any decisions.

BDO is an international network of independent audit and advisory firms. Service provision within the BDO network is coordinated from the Brussels global office. BDO's beginnings go back to 1963. We have been present in Poland since 1991. We have 5 offices in: Warsaw, Kraków, Poznań, Wrocław and Katowice.

BDO has for years been recognized in prestigious rankings of the activities performed by its Audit and Tax Advisory Departments, including most recently:

The last distinctions for the company are related to the Rankings:

Companies and Tax Advisors of Dziennik Gazeta Prawna for 2022:

■ 1st place The Best Tax Advisor in the category of medium-sized companies

The 2023 rankings prepared by the Rzeczpospolita and Parkiet dailies:

■ 4th Most Active Firm on the Stock Exchange

■ 5th Best Audit Firm

■ 4th Best Auditor of Listed Companies

■ The ESG award

BDO spółka z ograniczoną odpowiedzialnością sp.k., ul. Postępu 12, 02-676 Warszawa;
tel.: +48 22 543 1600, fax: +48 22 543 1601, e-mail: office@bdo.pl

BDO