BDO

May 2021

Interest loss may be recognized on the disposal of treasury securities

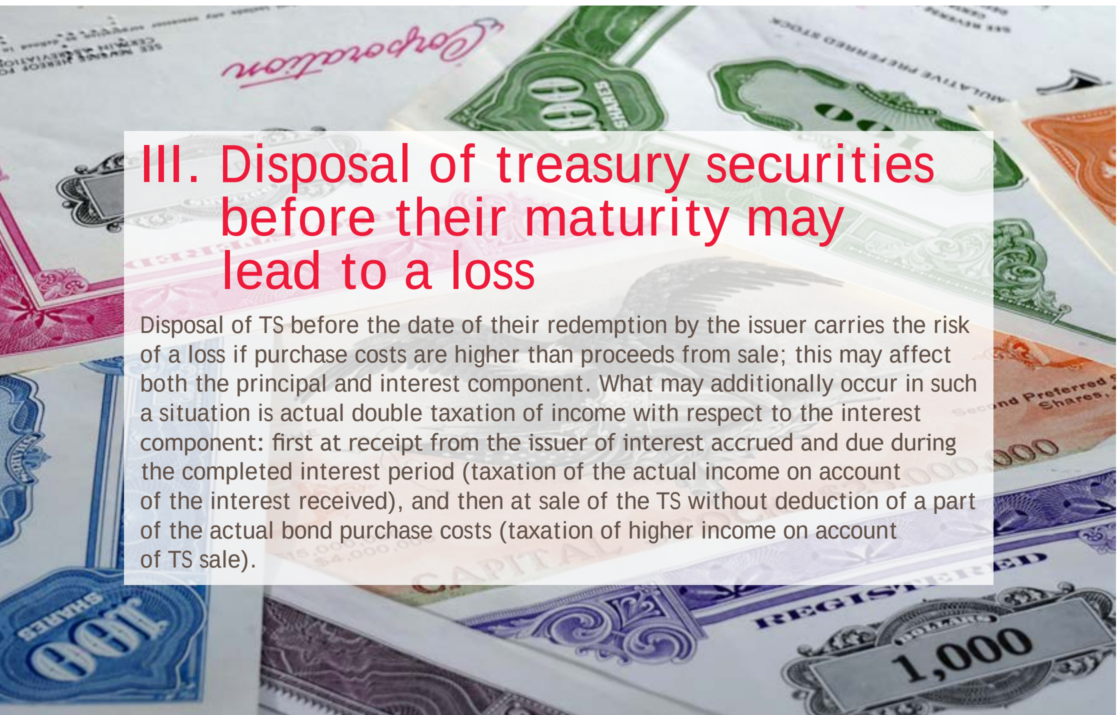
Pursuant to the CIT Act, the costs of purchase of bills and bonds issued by the State Treasury (treasury securities, TS) are tax deductible costs. The provision on exclusion of losses on disposal of receivables against consideration from tax deductible costs does not apply to disposal of TS, according to the latest general interpretation issued by the Minister of Finance.

I. General Interpretation clarifies how to determine costs on disposal of treasury securities

At the end of April, the Minister of Finance, Funds and Regional Policy issued a general interpretation regarding determination for corporate income tax purposes of tax deductible costs on disposal against consideration of treasury securities (No. SP4.8203.2.2020). Therefore, the interpretation concerns the disposal against consideration of bills and bonds issued by the State Treasury (TS). The aim of the interpretation is to determine whether, in connection with such disposal, the costs of purchase of TS are tax deductible expenses and in what amount such costs should be determined, i.e. whether they are tax deductible in full or only in part if their sale price is lower than the purchase price.

II. On purchase of treasury securities, interest may take the form of discount

Treasury bonds may be interest-bearing or sold at a discount, while discount is the only option for treasury bills. Interest may be fixed or variable, while discount is fixed only. Treasury bills and discount treasury bonds (also known as zero-coupon bonds) are issued at a discount to their nominal value. This means that their issue price is set by the Minister of Finance below their nominal value. The difference between the nominal value and the lower issue price is called discount. In economic terms, the purchase price of such bills and bonds is their nominal value less the interest due in the future, and their redemption at nominal value includes capitalized interest in the form of discount.



III. Disposal of treasury securities before their maturity may lead to a loss

Disposal of TS before the date of their redemption by the issuer carries the risk of a loss if purchase costs are higher than proceeds from sale; this may affect both the principal and interest component. What may additionally occur in such a situation is actual double taxation of income with respect to the interest component: first at receipt from the issuer of interest accrued and due during the completed interest period (taxation of the actual income on account of the interest received), and then at sale of the TS without deduction of a part of the actual bond purchase costs (taxation of higher income on account of TS sale).

IV. Expenditure on purchase constitutes cost, while any loss incurred is not subject to exclusion

Tax regulations (Article 16 clause 1 point 8 and point 39 of the CIT Act) exclude from tax deductible costs both the expenditure on purchase of securities, at the same time providing for their deductibility on disposal (redemption by the issuer included), and any loss on disposal of receivables against consideration. In this context, the Minister of Finance explained that expenditure on purchase of TS constitutes tax deductible cost, while the exclusion from deductible costs of the loss on the sale of receivables against consideration does not apply the sale of TS. Namely, according to the Minister of Finance, TS cannot be regarded as receivables within the meaning of the CIT regulations which exclude losses on the sale of receivables from tax deductible costs.

V. Treasury securities cannot be treated as ordinary receivables

The Minister of Finance is of the opinion that interpretation of the CIT Act leading to inconsistent classification of the same economic phenomenon or the same legal institution under different provisions would be unacceptable. Therefore, it cannot be assumed that the intention of a rational legislator was to shape the provisions of the Act in such a way that a TS would be called and understood simultaneously as a bond, a security, a loan and a receivable, especially if such classifications might lead to inconsistent or even different tax consequences. This is all the more justified as in the construction of the legal definition of income from capital gains, the legislator classifies "income from securities" and income from their sale separately from "income from disposal of receivables." Against this background, it would be unjustified to claim that the term "TS" is the same as "receivables".

VI. Real costs must be allocated to the revenues to which they relate

In the Minister's opinion, an interpretation of the term "receivable" as used in the provisions of the CIT Act that exclude losses on the sale of receivables from tax deductible costs should not lead to unconditional extension of that regulation's subjective scope to cover all receivables contained in or arising from the subject of disposal against consideration. This would create the risk of violation of strict interpretation of provisions that constitute exceptions to the rule, and of the prohibition on extending interpretation of such provisions. Moreover, the effects of the resulting interpretation as regards taxation of disposal of property and property rights would be irrational, and in certain circumstances even contrary to what the legislator originally desired or intended. Such exclusion of actually incurred expenses would violate the very essence of tax deductible costs, which is contained in deductibility of real and definitive income-related expenses.

VII. The interest component of actually incurred costs of purchase may be treated as tax deductible

If bonds with fixed or variable interest are purchased, the purchase price may include - in addition to the nominal value – also the value of interest, whether future (purchase from the issuer) or already accrued (purchase on the secondary market). That part of the expenditure becomes tax deductible in the case of disposal against consideration or redemption of treasury bonds. Instead, interest accrued and received before the disposal (redemption) of treasury bonds constitutes taxable income. Therefore, if treasury bonds are sold before their redemption by the issuer - which is a frequent and usual market practice, especially in the interbank market - and the sale price only corresponds to the nominal value, then the interest component of the actual expenditure on the purchase of such bonds may be treated as tax deductible costs.

VIII. A treasury security is either a bond or a treasury bill

According to the current regulations (Public Finance Act), "a treasury security is a security in which the State Treasury states that it is the security holder's debtor and undertakes to deliver to that holder a specific performance, which may be either pecuniary or non-pecuniary".
TS include two basic types of securities: treasury bills and treasury bonds. As defined in the act, "a treasury bill is a short-term security offered for domestic sale on the primary market at a discount and redeemed at par upon expiration of the period for which it was issued".
In contrast, "a treasury bond is a security offered for domestic or international sale, bearing interest or sold at a discount".

RAFAŁ KOWALSKI
Head of Tax Department
tel.: +48 22 543 16 00
Rafal.Kowalski@bdo.pl

IX. Various interest options of treasury securities

Fixed interest rate means that the rate remained unchanged throughout the contractual period of investment. The interest rate is set in advance in the letter of issue of specific treasury bonds, and does not change until the end of the investment (sale or redemption of bonds). Fixed interest accrues over specific periods (so-called interest periods). On the end of the interest period, interest is paid or capitalized. Variable interest rate changes during the investment period. The rate and its changes depend on indexes used to determine the interest rate for subsequent interest periods. A special case of variable interest rate is indexed interest rate. Such interest rate depends on a specific index, usually the inflation rate.

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